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, 2009 AND 2008

AUDIT REPORT NO. M-000-10-001-C
November 16, 2009

WASHINGTON, DC

Office of Inspector General
for the Millennium Challenge Corporation

November 16, 2009

Darius Mans
Acting Chief Executive Officer
Millennium Challenge Corporation
875 15th Street, N.W.
Washington, DC 20005-2221

Subject: Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2009 and 2008
Report No. M-000-10-001-C

Dear Mr. Mans,

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, 2009. 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 as amended, *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, 2009 the auditors found:

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

A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Cotton & Company LLP reported the following internal control significant deficiencies:

1. Control over Mission Activities and Support (material weakness)

2. Quality Control over Financial Reporting

3. Controls over Payroll Processes

4. Proper Reporting Period

5. Fund Balance with Treasury Reconciliation

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 13, 2009, 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 made the following recommendations to MCC's management on November 09, 2009:

1. Controls over Mission Activities and Support (material weakness)

1.1 Untimely Performance and Lack of Monitoring of MCA Audits

Recommendations: We recommend that the MCC Department of Compact Implementation and Division of Finance:

- Strengthen the monitoring of the MCA audit process, from submission of the audit plan through issuance of the audit report to ensure timely completion and sufficient time for OIG review, prior to issuing the report to MCC for management comment.

- Increase communication between the MCAs, the audit firms, and the OIG to ensure all parties are adequately informed of the progress of all audits in a timely manner. Ensure that the MCAs understand the impact of these audits and how they affect MCC's assessment of overall controls and its financial statement audit.

1.2. Lack of Adequate Documentation to Support Transactions

Recommendation: We recommend that MCC management, in coordination with the U.S. Agency for International Development (USAID), establish effective and periodic communication with MCA and Threshold mission personnel, to emphasize the need for proper documentation to be maintained in the MCA files, and that these documents are readily available and promptly submitted for inspection when requested.

1.3 Improper Reporting of Re-disbursements

Recommendations: We recommend that MCC Department of Compact Implementation and Division of Finance:

- Develop training for MCA Fiscal Agents to ensure proper reporting of re-disbursements on the QFRs to ensure the MCA is only requesting advances for immediate funding needs.

- Develop a tracking mechanism to monitor prepayments and to ensure that MCC and NBC personnel are properly reviewing the quarterly submitted QFRs for proper reporting of both the projected needs for advancement of funds and actual re-disbursements of previously advanced funds.

2. Quality Control over Financial Reporting

Recommendations: We recommend that the MCC Division of Finance:

- Strengthen its quality control reviews over financial statements, notes, and other information presented, to ensure the information received is accurate, complete, and complies with accounting standards and reporting guidance.

- Increase communication with USAID to ensure information received has been reviewed and is reliable, in order for MCC to prepare complete and accurate financial statements in accordance with accounting standards and reporting guidance.

3. Controls Over Payroll Processes

3.1 Untimely and Incomplete Processing of Separated Employees

Recommendations: We recommend that the MCC Division of HR:

- Ensure all HR personnel are aware of the requirement to document and retain the employee exit form in the OPF. In addition, direct HR personnel to obtain completed employee exit form from the Division of Security in a timely manner and document it properly in the employee's OPF.

- Direct HR personnel to follow up on all missing items when performing the OPF audits and completing the Purged OPF Check List.

- Develop and implement a process to monitor and ensure that HR and/or NBC personnel are completing leave audits as required and processing payments for amounts due to, or amounts owed by, separating employees on a timely basis.

3.2 Improper and/or Lack of Certification on the SF-52 and SF-50

Recommendations: We recommend that the MCC Division of HR:

- Review its current policies and procedures to ensure that proper authorization and approval of personnel actions are clearly documented on the required forms prior to processing.

- Direct HR personnel to adhere to the documented policies and procedures when preparing, reviewing, and approving personnel actions, to ensure reviews and approvals are properly documented.

- Provide the necessary training to responsible HR personnel to ensure that they are aware of the need for properly documenting reviews and approvals of personnel transactions.

3.3 Lack of Support for Employee Selected Benefit Deductions

Recommendations: We recommend that the MCC Division of HR:

- Establish a consistent tracking mechanism or other historical file for MCC employees to document all changes in employee benefits that are not documented using standard forms or Employee Express.

- Revise current policies and procedures to ensure that supporting documentation for all transactions processed by HR personnel on behalf of MCC employees are clearly documented either in the OPF or other historical file, and are readily available for examination.

4. Proper Reporting Period

Recommendations: We recommend that MCC Division of Finance:

- Continue to strengthen, and revise as necessary, policies and procedures for yearend accruals to ensure that all countries, types of funding, and programs are considered when recording estimates for future expenses, and that accruals are reasonably sufficient to cover anticipated costs.

- Establish and communicate procedures for the MCAs to require the submission of estimates or payment requests for current period expenses that have not, or will not be recorded until the subsequent year, for each fund type.

- Ensure that the accrual amount is adequately and reasonably calculated, clearly documented and supported, and properly reviewed for completeness and accuracy prior to and subsequently after posting to the GL.

5. FUND BALANCE WITH TREASURY (FBWT) RECONCILIATION

Recommendations: We recommend that the MCC Division of Finance:

- Inquire of USAID's procedures to resolve the issue of incomplete SF 224 reporting.

- Consider revisions to the Memorandum of Agreement (MOA) with USAID to require timely responses upon inquiry by MCC management regarding financial statement audit findings related to Threshold Program transactions.

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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INDEPENDENT AUDITOR'S REPORT

We have audited the Balance Sheets of the Millennium Challenge Corporation (MCC) as of September 30, 2009 and 2008, and the related Statements of Net Cost, Changes in Net Position, and Budgetary Resources for the years 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.

We conducted our audits 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 audits provide 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, 2009, and 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 13, 2009, 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 audits.

COTTON & COMPANY LLP

Colette Y. Wilson, CPA
Partner

November 13, 2009
Alexandria, Virginia

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

We have audited the Balance Sheet of the Millennium Challenge Corporation (MCC), as of September 30, 2009 and 2008, and the related Statements of Net Cost, Changes in Net Position, and Budgetary Resources for the years then ended. We have issued our report thereon dated November 13, 2009. 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 audits, 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 five 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.

- Controls Over Mission Activities and Support
- Quality Control Over Financial Reporting
- Controls Over Payroll Processes
- Proper Reporting Period
- Fund Balance with Treasury Reconciliation

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 Controls over Mission Activities and Support to be a material weakness as defined above.

CONTROLS OVER MISSION ACTIVITIES AND SUPPORT

The vast majority of activities and expenses occur in the Compact and Threshold programs. As such, controls in the mission countries should be adequately designed and operate effectively. In addition, MCC should be adequately monitoring those controls to gain assurance over the activities taking place and the resulting financial information being reported. During our audit, we noted areas of weakness related to the monitoring of audits, completion of those audits, control activities in the countries, and the ability to provide underlying support for transactions. These areas, which represent a lack of controls over activities and support, are detailed below.

Untimely Performance and Lack of Monitoring of MCA Audits

Audits of controls, transactions, and balances of Millennium Challenge Accountable Entities (MCA) are not completed and submitted to the Office of Inspector General (OIG) in a timely manner. In addition, MCC is not adequately monitoring the start and completion of these audits to ensure a timely submission of audit reports and notification of findings. This increases MCC's risk of not being informed of MCA activities that would affect the financial statements in a timely manner.

As a major component of internal control over the MCAs, MCC requires audits to be conducted on a semiannual basis for the six months ending December and June of each year. The results of the audits give MCC some assurance over the validity and accuracy of payments and advances that are processed for the MCAs and reported in its financial statements. This assurance is needed as invoices and other underlying supporting documentation for transactions are not reviewed or maintained by MCC or the National Business Center (NBC). Instead, MCC relies on approved request documents submitted by MCA personnel.

Based on our inquiries and review of the timing of audit planning documents and audit reports submitted by the MCA auditors, we concluded that MCC is not adequately monitoring the start and completion of the MCA audits. Details of our review for the 16 countries that had entered into force, as of June 30, 2009, follow.

For audits conducted for the six months ending December 31, 2008, in which audit reports were due by March 31, 2009, we noted the following:

- The OIG issued nine audit reports, of which seven were submitted between 28 and 45 days late.
- Four audit reports that have yet to be issued by the OIG, were also submitted after the due date; one in early June 2009, and three in July 2009.
- Audits were not conducted for two MCAs (Morocco and Mozambique) that entered into force in September 2008; the first audits were extended into the next audit period.

- One audit (MCA Honduras) has not started due to failed procurements.

For audits conducted for the six months ending June 30, 2009, in which audit reports were due by September 30, 2009, we noted the following:

- Audit planning documents for eight audits were submitted and approved after June 30, 2009 (one in July, six in August, and one in September), and one has not been received (MCA Honduras is still experiencing procurement delays). Planning documents are required to be approved by the OIG prior to commencement and audit work should begin within the audit period to ensure effective testing of controls.

- Thirteen audit reports are currently past due; only one was submitted to the OIG by the due date and two were submitted in October. Outstanding audit reports include MCAs Morocco and Mozambique, which have now been in operation for one year since entering into force.

Outstanding audit reports for the period ending June 30, 2009, which cover two quarters of fiscal year (FY) 2009 activity, will now be received well after the current fiscal period, and would not be useful in MCC's assessment or assurance of FY 2009 activities. Some audits were delayed due to procurement issues, extended audit periods for MCAs that entered into force during an audit period, and the OIG's delayed issuance of final reports. However, audit reports that are not issued in a timely manner increase the risk that MCC will not be notified of potential inadequate controls and inaccurate financial information, which could have a material impact on MCC's financial statements. In addition, we noted that OIG comments on the audit reports relate to questionable amounts presented, clarification of audit findings, and lack of adherence to audit requirements and formatting of reports. Resolution of these comments is dependent on sufficient and timely responses from the MCA auditors.

Also during testing of internal controls we noted instances of Quarterly Financial Reports (QRF) being submitted after required deadlines and Payment Request Forms (PRF) that were not properly approved prior to requesting disbursement from MCC.

OIG's *Guidelines or Financial Audits Contracted by the Millennium Challenge Corporation's Accountable Entities* (Guidelines; revised August 2007), states:

> *MCC standard audit provisions require that the Accountable Entity (hereafter referred to as MCA) ensures that an audit is contracted by MCA for itself at least annually in accordance with these Guidelines. The MCC may require more frequent audits than annually* (§1.5).
>
> *MCC responsibilities are to: 1) monitor and ensure that the required contracted audits of the MCA and all non-US governmental and nongovernmental covered providers expending more than $300 thousand in their fiscal year are performed in a timely manner; 2) ensure the audits are performed by auditors on the list of approved auditors; and 3) make sure proper action is taken to correct deficiencies identified by the auditors. … The MCC is also responsible for ensuring that audit contract agreements between MCA and Covered Providers, subject to audit, and their independent auditors contain a standard statement of work that includes all the requirements of these Guidelines* (§1.8).
>
> *All required audits must be completed and the reports issued in accordance with the compact (no later than 90 days after the end of the audit period) or such other periods as Parties may agree in writing. Extensions must be requested by the MCA and the Covered Provider in advance of the*

> *audit due date. The approval of the extension will be coordinated and approved by the Office of the Inspector General on a case by case basis* (§1.15).
>
> *The OIG must receive the audit report in accordance with the Compact, no later than 90 days after the first anniversary of the Entry into Force and no later than 90 days after the end of the audited period thereafter, or such other periods as the Parties may otherwise agree* (§2.3).

Not closely monitoring the MCA audit process increases MCC's risk that MCAs are incurring costs and requesting advances that are potentially unallowable, incorrect, or not supported by underlying documentation. In addition, there is a risk that the MCAs do not have appropriate internal control structures in place that MCC can rely upon for approval of advance and payment requests.

Recommendations: We recommend that the MCC Department of Compact Implementation and Division of Finance:

- Strengthen the monitoring of the MCA audit process, from submission of the audit plan through issuance of the audit report to ensure timely completion and sufficient time for OIG review, prior to issuing the report to MCC for management comment.

- Increase communication between the MCAs, the audit firms, and the OIG to ensure all parties are adequately informed of the progress of all audits in a timely manner. Ensure that the MCAs understand the impact of these audits and how they affect MCC's assessment of overall controls and its financial statement audit.

Lack of Adequate Documentation to Support Transactions

MCA and Threshold missions did not provide or respond to our requests for supporting documentation in a timely manner for all expense and undelivered order sample items. Prior to yearend testing, we informed MCC that documentation would be requested from the MCA and Threshold missions for substantiation of yearend balances and that due to tight deadlines for the audit, responses would be required within five days. This detailed, written information was communicated to all MCA and Threshold mission points of contact.

Upon submission of the sample items, some countries responded in a timely manner, while others provided either incorrect, insufficient, or no documentation at all. MCC was advised of the lack of responses and in turn sent several emails to the countries and agency points of contact, in efforts to obtain the supporting documentation. Significant amounts remained unsupported at the conclusion of audit fieldwork.

The Government Accountability Office (GAO) *Standards of Internal Control*, 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. … All documentation and records should be properly managed and maintained (page 15).*

Documentation was not provided or was insufficient to support the following:

- Expenses for Compacts and Threshold transactions, in the amounts $995,737 and $2,269,864, respectively.

- Undelivered Orders for Compact and Threshold balances, in the amounts of $620,217 and $5,665,222, respectively.

Lack of response and submission of underlying documentation by the MCA and Threshold missions weakens the oversight and monitoring of mission activities and increases the risk of MCC reporting inaccurate balances in its trial balance and financial reports.

Recommendation: We recommend that MCC management, in coordination with the U.S. Agency for International Development (USAID), establish effective and periodic communication with MCA and Threshold mission personnel, to emphasize the need for proper documentation to be maintained in the MCA files, and that these documents be readily available and promptly submitted for inspection when requested.

Improper Reporting of Re-disbursements

During a review of outstanding advances, we noted that re-disbursements for a compact and 609(g) funding were not applied to earlier, outstanding advances, and/or were not properly reported by the MCA. Details of our review at interim are as follows:

Vanuatu partially liquidated an April 2008 advance in April 2009, and had additional outstanding advances from FY 2008 that also had not been liquidated (one from June 2008, two from August 2008, and one from September 2008). These advances were not reported as disbursements on the MCA's Quarterly Financial Report (QFR) until April 2009; thus, the additional advances received after April 2008 may not have been needed.

Ghana's 609(g) disbursements for advances received in FYs 2008 and 2009 were not reported in a timely manner; they were reported on its June 2009 QFR. Funds were continually advanced on subsequent disbursement packages without discussion with the MCA as to why the amounts were not included on subsequent QFRs for proper re-disbursement recording in the general ledger (GL).

Volume 1, Part 6, *Other Fiscal Matters*, of the Treasury Financial Manual (TFM), states:

> *Advances to a recipient organization will be limited to the minimum amounts necessary for immediate disbursement needs and will be timed to be in accord only 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 the actual disbursements by the recipient organization for direct program costs and the proportionate share of any allowable indirect costs. (§2025)*

Monitoring and review procedures were not sufficient by MCC and NBC to ensure that aged advances were completely liquidated prior to issuing further advances and liquidating subsequent advances. In addition, MCAs that do not properly or timely report their actual re-disbursement amounts cause MCC's Congressional reporting to be inaccurate.

Recommendations: We recommend that MCC Department of Compact Implementation and Division of Finance:

- Develop training for MCA Fiscal Agents to ensure proper reporting of re-disbursements on the QFRs to ensure the MCA is only requesting advances for immediate funding needs.

- Develop a tracking mechanism to monitor prepayments and to ensure that MCC and NBC personnel are properly reviewing the quarterly submitted QFRs for proper reporting of both the projected needs for advancement of funds and actual re-disbursements of previously advanced funds.

QUALITY CONTROL OVER FINANCIAL REPORTING

MCC addressed the prior year recommendation to effectively coordinate with service providers to ensure timely receipt of yearend trial balance and adjustment information. However, quality control procedures performed on consolidated financial information presented in the Agency Financial Report (AFR) require additional improvement.

Yearend quality control reviews were not performed sufficiently to detect material misstatements and identify questionable and significant variances. Specifically, we noted the following:

- A $7.9 million overstatement in Upward Adjustments of Prior Year Undelivered Orders was reported in the initial yearend financial statements. The overstatement, which was not detected by MCC or USAID, was discovered upon our inquiry of the nearly $8 million increase in GL account 4881 for the Threshold program when the prior yearend balance was only $396,264. In response to our inquiry, USAID personnel noticed a posting error for both the third and fourth quarter amounts. Per their explanation, the deobligation and reobligation adjustments were based on cumulative amounts reported for the entire year, instead of amounts for just the related quarter. In addition, these amounts included adjustments for subobligations, which should not have been included, as these amounts are already recorded at the initial bilateral obligation level.

- USAID personnel also noted that similar errors were made to GL account 4871 for downward adjustments, resulting in a $432 thousand misstatement. These errors were corrected and adjustments were posted to the final trial balance for inclusion in the financial statements.

Additionally, detailed quality control reviews of consolidated financial information were not sufficient to ensure mathematical accuracy and presentation of comparable data between the trial balance, statements, and notes. During our review of the statements, notes, and information in the Management's Discussion and Analysis (MD&A) section, we noted the following:

- The presentation in the notes for Intra-governmental and Public costs, as well as Undelivered Orders, did not tie to amounts by program, as recorded in the trial balance. In addition, the total amount of costs did not tie to the Statement of Net Cost as it did for the prior year.

- The presentation of funding, by program, in the initial MD&A did not tie to amounts recorded in the trial balance.

- Current and prior year amounts were not consistent in terms of classification in line items and presentation of amounts as positive or negative.

- Mathematical errors, including some due to rounding, were noted not only in the initial AFR, but also in the revised version presented for audit.

- Performance information presented in initial and revised versions of the AFR was not clearly defined and amounts cited for targets were incorrect.

GAO *Standards of Internal Control*, 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 (page 11).*

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….*

Financial statements presented for audit are the responsibility of MCC. Without conducting or ensuring effective, detailed analyses and quality control reviews over consolidated financial information, MCC is at risk for presenting statements that are not comparative, accurate, or in compliance with applicable requirements and accounting standards.

Recommendations: We recommend that the MCC Division of Finance:

- Strengthen its quality control reviews over financial statements, notes, and other information presented, to ensure that information presented for audit is accurate, complete, and complies with accounting standards and reporting guidance.

- Increase communication with USAID to ensure information received has been reviewed and is reliable, in order for MCC to prepare complete and accurate financial statements in accordance with accounting standards and reporting guidance.

CONTROLS OVER PAYROLL PROCESSES

Untimely and Incomplete Processing of Separated Employees

Human Resource (HR) personnel are not proactive in obtaining the completed employee exit forms from the Division of Security, nor are they including copies of employee exit forms in the Official Personnel File (OPF). During our testing of 10 separated employees, we noted that employee exit forms were not properly documented in the OPF for all 10 employees sampled. MCC conducted OPF audits in which all sampled employees were included. When completing the Purged OPF Check List, it was simply documented that the employee exit form was not included in the OPF prior to being sent to storage or to the transferring employee's new agency.

In addition, we noted that for one separated employee, the lump sum payment for annual leave was not received until the 5th pay period after separation from MCC. MCC provided no explanation for the delay in performing the leave audit and processing the lump sum payment; normal processing time is two pay periods.

MCC's *Policy and Procedures on Employee Exit Procedures*, Section 5.2, states the following:

> *After the entire exit form is complete with signatures, the employee will meet with HR for an exit interview and final checkout…. The HR representative will witness the employee's final signature*

on the MCC Exit Form, noting the return of all MCC property. The HR representative will retain a copy of the exit form, place it in the employee's historical personnel file, and provide the employee a copy…. After the employee has turned in their MCC badge to the Associate Director for Security, the form will be submitted to the HR division for their personnel file.

The *Purged OPF Check List* lists the documents to be included in the OPF:

Copy of Employee Exit Form – filed on left side.

GAO *Standards of Internal Control*, states:

Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded (page 15).

By not adhering to the process of completing and retaining the employee exit form, the risk increases that MCC employees may not return all required property before separating from the agency. In addition, the untimely processing and payment of amounts owed to its employees increases the agency's risk of retaining excessive liabilities or long-term receivables on its books for excessive periods of time.

Recommendations: We recommend that the MCC Division of HR:

- Ensure all HR personnel are aware of the requirement to document and retain the employee exit form in the OPF. In addition, direct HR personnel to obtain completed employee exit form from the Division of Security in a timely manner and document it properly in the employee's OPF.

- Direct HR personnel to follow up on all missing items when performing the OPF audits and completing the Purged OPF Check List.

- Develop and implement a process to monitor and ensure that HR and/or NBC personnel are completing leave audits as required and processing payments for amounts due to, or amounts owed by, separating employees on a timely basis.

Improper and/or Lack of Certification on the SF-52 and SF-50

During our testing of controls over personnel actions, we noted that HR personnel are not properly preparing and certifying the Standard Form (SF) 52, *Request for Personnel Action*, and the SF 50, *Notification of Personnel Action.* HR specialists are not certifying SF-52s in Part C-2 to show evidence of approval of the personnel action processed. In addition, they are not properly reviewing the SF-52s to ensure all necessary signatures are obtained to ensure the actions were properly requested and authorized prior to processing the action, nor are they signing the SF-52 as the preparing individual.

During testing of controls over 10 newly hired employees, we noted the following:

- Three SF-52s that were not signed or dated for approval

- One instance in which the SF-52 and SF-50 were prepared and certified by the same HR specialist

- Five SF-50s that were approved after the effective date of the personnel action

In addition, during testing controls over the processing of SF-52s for 45 employees, we noted:

- Twelve SF-52s did not have the signature of a Certification Officer in Part C-2

- Two instances in which the SF-52 and SF-50 were prepared and certified by the same HR specialist

- One SF-52 was not signed by the requesting and authorizing officials

- One SF-50 had an approval date that occurred before the requesting and authorizing dates

MCC's documented procedures for processing SF-52s state that the HR specialist should not sign the SF-50, and that SF-52s and SF-50s should not be released until all actions have been reviewed and approved.

U.S. Office of Personnel Management (OPM), *Guide to Processing Personnel Actions*, states:

> *No personnel action can be made effective prior to the date on which the appointing officer approved the action. That approval is documented by the appointing officer's pen and ink signature or by an authentication, approved by the Office of Personnel Management, in block 50 of the Standard Form 50, or in Part C-2 of the Standard Form 52. By approving an action, the appointing officer certifies that the action meets all legal and regulatory requirements and, in the case of appointments and position change actions, that the position to which the employee is being assigned has been established and properly classified* (§4b, *Effective Dates).*
>
> *As explained in paragraph 4b, most personnel actions must be approved by the appointing officer on or before their effective dates. An appointing officer is an individual in whom the power of appointment is vested by law or to whom it has been legally delegated. Only an appointing officer may sign and date the certification in Part C-2 of the Standard Form 52 or blocks 50 and 49 of the Standard Form 50 to approve an action* (§4c, *Approval of Personnel Actions)*

GAO *Standards of Internal Control*, states that:

> *Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets (page 14).*

Not adhering to procedures for preparing and approving personnel actions and establishing proper segregation of duties increases the risk that personnel actions may be processed that are not properly authorized or approved.

Recommendations: We recommend that the MCC Division of HR:

- Review its current policies and procedures to ensure that proper authorization and approval of personnel actions are clearly documented on the required forms prior to processing.

- Direct HR personnel to adhere to the documented policies and procedures when preparing, reviewing, and approving personnel actions, to ensure reviews and approvals are properly documented.

- Provide the necessary training to responsible HR personnel to ensure that they are aware of the need for properly documenting reviews and approvals of personnel transactions.

Lack of Support for Employee Selected Benefit Deductions

During testing of payroll and personnel transactions for 45 employees over two pay periods, we noted 14 instances in which documentation was not readily available or was not provided to support the amount deducted for Thrift Savings Plan (TSP) benefits. Of these 14 instances, we noted nine instances in which the deduction taken did not agree with the amount authorized by the employee.

GAO *Standards of Internal Control*, states:

> *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 (page 15).*

OPM's *The Guide to Personnel Recordkeeping*, states in Chapter 3, *Filing Documents in the Personnel Folder*, states:

> *Records are filed in the Official Personnel Folder to document events in an individual's Federal employment history that have long-term consequences for the employee and for the Government. Care should be exercised in filing documents correctly to ensure all documents pertaining to an employee's rights and benefits are available in the personnel folder when needed.*

Instead of using the proper TSP form or accessing Employee Express, employees are emailing the HR specialist with the authorized amount to process for their TSP deduction. HR does not maintain in the OPF or in a centralized location, authorizations that are not documented using the standard form. For differences noted during the audit, the HR specialist could not readily produce the emails and had to search archived emails for the employee's authorization for the change in deduction amount.

Not using proper forms or maintaining a record of changes made to employee deductions increases the risk that incorrect deductions may be made for enrolled benefits.

Recommendations: We recommend that the MCC Division of HR:

- Establish a consistent tracking mechanism or other historical file for MCC employees to document all changes in employee benefits that are not documented using standard forms or Employee Express.

- Revise current policies and procedures to ensure that supporting documentation for all transactions processed by HR personnel on behalf of MCC employees are clearly documented either in the OPF or other historical file, and are readily available for examination.

PROPER REPORTING PERIOD

Expenses for goods and services received and performed were not recorded in the proper period. We noted FY 2008 transactions recorded in the current fiscal year for which accruals had not been posted. In addition, we noted FY 2009 accrual transactions recorded in the beginning of FY 2010 that were not estimated and recorded.

This is a repeat finding from the FY 2008 audit where MCC's accrual processes were not sufficient to identify and compute amounts owed, but not paid, in the appropriate period. MCC did make improvements to their yearend accrual processes by contacting NBC for a listing of FY 2009 invoices and payment requests received but not paid in the first nine days of FY 2010, and ensuring comprehensive coverage of all funds, interagency agreements, and vendor contracts. However, significant amounts still lacked appropriate accruals and were recorded in the wrong period. It was also noted that expenses were reported in the wrong period for Threshold program costs.

Statements of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, (pp. 22 and 23) requires "a liability is 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."

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

Unrecorded accruals for FY 2008 expenses reported in FY 2009 resulted in overstated expenses as follows:

- Compact and Compact Implementation funds in the amount of $1,902,313
- Administrative and Due Diligence funds in the amount of $2,249,188
- Threshold Program funds in the amount of $702,950

Unrecorded accruals for FY 2009 expenses reported in FY 2010 resulted in understated expenses as follows:

- Compact funds in the amount of $2,632,499
- Threshold Program funds in the amount of $22,568

By not accruing for expenses in the proper period, FY 2009 expenses were overstated by $2,199,384.

USAID also recorded an adjustment to the Threshold program accrual amounts, as a result of significant deficiencies noted in the accrual reporting system, which were calculated and posted to the GL.

Recommendations: We recommend that MCC Division of Finance:

- Continue to strengthen, and revise as necessary, policies and procedures for yearend accruals to ensure that all countries, types of funding, and programs are considered when recording estimates for future expenses, and that accruals are reasonably sufficient to cover anticipated costs.

- Establish and communicate procedures for the MCAs to require the submission of estimates or payment requests for current period expenses that have not, or will not be recorded until the subsequent year, for each fund type.

- Ensure that the accrual amount is adequately and reasonably calculated, clearly documented and supported, and properly reviewed for completeness and accuracy prior to and subsequently after posting to the GL.

- Ensure that USAID has procedures to resolve incorrect accruals and to make certain that quarterly and yearend amounts for the Threshold program are complete and accurate.

FUND BALANCE WITH TREASURY (FBWT) RECONCILIATION

USAID administers the Threshold Program for MCC, and Phoenix is the accounting system of record. During the review of internal controls, we noted that the monthly SF 224s, *Statement of Transactions*, which include mission transactions for MCC's Threshold Program, did not include all monthly cash disbursements and cash receipts recorded in Phoenix. Instead, only cash disbursements and cash receipts that are in agreement with those recorded and confirmed in Treasury's system are reported to avoid having differences reported back by Treasury on the SF-6652, *Statement of Differences* (SOD). In addition, quarterly cash adjustments are posted to the GL in order to agree the FBWT account balance to the cash balance reported by Treasury. At yearend, it was noted that the missions followed the same procedures in preparing the September SF 224s.

The Treasury Financial Manual (TFM), *Preparing FMS 224*, §3330 states:

> *Agencies prepare the monthly FMS 224 based on:*
> - *Vouchers paid or accomplished by [Regional Finance Centers (RFC)];*
> - *Intra-governmental Payments and Collections (IPAC) transactions accomplished;*
> - *Cash collections received for deposit on SF 215s [Deposit Ticket]; and*
> - *Electronic payments/deposits such as those processed through the Automated Standard Application for Payments (ASAP) System or the Fedwire Deposit System.*
>
> *Agencies also should report transactions recorded in their [GL] that are not associated with an SF 215, SF 5515 [Debit Voucher], IPAC, or vouchers paid or accomplished by RFCs in Section I of the FMS 224 only.*

§V, Subsection C, *Adjustments*, of Part 2-5100 states:

> *An agency may not arbitrarily adjust its FBWT account. Only after clearly establishing the causes of errors and properly documenting those errors, should an agency adjust its FBWT account balance.*

Improper reporting of FBWT to Treasury via the SF-224s bypasses the mandatory reconciliation and review process by Treasury, which in turn increases the risk of errors and misstatements ultimately being reported in the financial statements.

Recommendations: We recommend that the MCC Division of Finance:

- Inquire of USAID's procedures to resolve the issue of incomplete SF 224 reporting.

- Consider revisions to the Memorandum of Agreement (MOA) with USAID to require timely responses upon inquiry by MCC management regarding financial statement audit findings related to Threshold Program transactions.

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

Colette Y. Wilson

November 13, 2009
Alexandria, Virginia

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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 Sheets of the Millennium Challenge Corporation (MCC) as of September 30, 2009 and 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 13, 2009. We conducted our audits 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 audits, 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 United States Agency for International Development (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

Colette Y. Wilson

November 13, 2009
Alexandria, Virginia

Status of Prior Year Findings

Following is the disposition of prior year (2008) findings, recommendations, and MCC Management's action.

Finding:

1. Absence of quality controls over financial reporting (material weakness)

.

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.

Status:

While improvements were made in the coordination with its service providers MCC still needs to strengthen its detailed quality control reviews and ensure that documented policies are finalized and adhered to.

We consider this FY 2008 condition to be unresolved as of September 30, 2009.

Finding:

2. Authorization for personnel actions inconsistent with stated policies and procedures.

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.

Status:

We consider this FY 2008 condition to be unresolved as of September 30, 2009, as similar findings are still noted by the auditors.

Finding

3. Transactions not recorded in the period they occurred

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.

Status:

While improvements were made to the methodology used to accrue for yearend expenses, significant amounts remained in the current year which related to the prior year.

We consider this FY 2008 condition to be unresolved as of September 30, 2009.

Finding

4. Lack of adequate review for accuracy and duplication prior to processing and recording transactions in General Ledger.

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.

Status:

We consider these FY 2008 conditions to be unresolved as of September 30, 2009

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 five recommendations included in this report and our evaluation of those comments.

Recommendation No. 1.1

MCC agrees with the recommendations. The MCC's Fiscal Accountability (FA) Directors will work with audit firms, MCAs and the OIG to ensure the timely completion and issuance of audit reports in the future. MCC has established a comprehensive audit tracking table to monitor the status of all MCA audits going forward, following up with MCAs to ensure timely completion, and providing notifications to the OIG on any issues or delays. MCC will stress to the MCAs the importance of timely audits as a part of MCC's overall system of strong internal controls.

Auditor Evaluation:

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

Recommendation No. 1.2

MCC agrees with the recommendation. MCC's Fiscal Accountability (FA) Directors will work with the MCAs to ensure that documentation to support transactions is in good order and readily available. With regard to the Threshold missions, MCC plans to meet with USAID management to discuss the lack of response from the missions, and determine what steps both MCC and USAID can take to avoid this issue for future audits.

Auditor Evaluation:

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

Recommendation No. 1.3

MCC agrees with the recommendations. MCC has developed a report to monitor prepayments and will work with the National Business Center (NBC) to ensure that the first in/first-out method is followed when liquidating MCA advances. In addition, the FA Directors will provide training as needed to ensure that the MCAs provide accurate reporting of re-disbursements in their quarterly reporting submissions to MCC. MCC wishes to note that with the implementation of the Common Payment System (CPS), the use of advances is now limited to payment of MCA salaries and small dollar items. CPS makes payments directly to vendors via the US Treasury, eliminating the need for large dollar advances to MCA bank accounts.

Auditor Evaluation:

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

Recommendation No. 2

MCC agrees with the recommendations. As noted in the audit report, MCC has made improvements in its quality control over financial report in FY 2009 (this item was a material weakness in FY 2008). In FY 2010, MCC will expand its review process to include quarterly fluctuation analysis of all materials accounts, review its reporting process to ensure that there is adequate time for an effective review process, and continue to coordinate with USAID on the timeliness and accuracy of financial data for the Threshold program.

Auditor Evaluation:

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

Recommendation No. 3.1

MCC agrees with the finding and recommendations. MCC's Human Resources division will establish procedures and controls to ensure that employee exit forms leave audits, and other requirements are met and filed in the OPF. MCC's HR division is undergoing a project to document all policies and procedures (develop or update as necessary) to ensure we are compliant with all federal requirements. These policies will include procedures and metrics where necessary to ensure we are complying with the policies. This project is scheduled to be complete by the end of November 2009.

Auditor Evaluation:

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

Recommendation No. 3.2

MCC agrees with recommendations. MCC's Human Resources division will establish procedures and controls to ensure proper personnel actions (SF-52/SF-50) documentation. MCC's HR division is undergoing a project to document all policies and procedures (develop or update as necessary) to ensure we are compliant with all federal requirements. These policies will include procedures and metrics where necessary to ensure we are complying with the policies. This project is scheduled to be complete by the end of November 2009

Auditor Evaluation:

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

Recommendation No. 3.3

MCC agrees with the findings and recommendations. MCC's Human Resources Division will establish procedures and controls to ensure proper documentation of employee change requests. MCC will also discontinue the practice of accepting TSP changes via email. Employees will be required to use the appropriate form or Employee Express for changes to their TSP accounts. MCC's HR division is undergoing a project to document all policies and procedures (develop or update as necessary) to ensure we are compliant with all federal requirements. These policies will include procedures and metrics where necessary to ensure we are complying with the policies. Project is scheduled to be complete by the end of November 2009.

Auditor Evaluation:

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

Recommendation No. 4

MCC agrees with the recommendations. MCC has implemented new formulation methodologies for its quarterly and year-end accruals that will ensure administrative; due diligence and program funds are accurately recorded. These new methodologies will be reflected in the update of MCC's financial management policy and procedures which will be released during the first quarter of FY 2010. MCC will meet with USAID management to discuss their procedures for ensuring that accruals reported as part of the quarterly reporting package to MCC are accurate and complete.

Auditor Evaluation:

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

Recommendation No. 5

MCC agrees with the recommendations. MCC plans to meet with USAID management to discuss their plan of action to resolve this finding. MCC will update the MOU with USAID to require a copy of USAIDs consolidated monthly reconciliation for the fund balance with Treasury as part of their oversight Threshold reporting. MCC's ability to implement the recommendation with regard to USAID will be dependent on their agreement to the terms of the MO, and their timely completion of FBWT reconciliations in accordance with established Treasury guidelines.

Auditor Evaluation:

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

Appendix C

MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Memorandum

TO: Alvin A. Brown
Assistant Inspector General

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

DATE: November 10, 2009

SUBJECT: Management Response to Draft Independent Auditor's Report on MCC's Financial Statements for Fiscal Years Ended September 30, 2009 and 2008, 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:

Balance Sheet;
Statement of Net Cost;
Statement of Changes in Net Position; and
Statement of 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: Controls over Mission Activities and Support

Recommendation No. 1: Untimely Performance and Lack of Monitoring of MCA Audits

We recommend that the MCC Department of Compact Implementation and Division of Finance:

- Strengthen the monitoring of the MCA audit process, from submission of the audit plan through issuance of the audit report to ensure timely completion and sufficient time for OIG review, prior to issuing the report to MCC for management comment.

- Increase communication between the MCAs, the audit firms, and the OIG to ensure all parties are adequately informed of the progress of all audits in a timely manner. Ensure that the MCAs understand the impact of these audits and how they affect MCC's assessment of overall controls and its financial statement audit.

Management Response

MCC agrees with the recommendations. The MCC's Fiscal Accountability (FA) Directors will work with audit firms, MCAs and the OIG to ensure the timely completion and issuance of audit reports in the future. MCC has established a comprehensive audit tracking table to monitor the status of all MCA audits going forward, following up with MCAs to ensure timely completion, and providing notifications to the OIG on any issues or delays. MCC will stress to the MCAs the importance of timely audits as a part of MCC's overall system of strong internal controls.

Recommendation No 2

We recommend that MCC management, in coordination with the U.S. Agency for International Development (USAID), establish effective and periodic communication with MCA and Threshold mission personnel, to emphasize the need for proper documentation to be maintained in the MCA files, and that these documents are readily available and promptly submitted for inspection when requested.

Management Response

MCC agrees with the recommendation. MCC's Fiscal Accountability (FA) Directors will work with the MCAs to ensure that documentation to support transactions is in good order and readily available. With regard to the Threshold missions, MCC plans to meet with USAID management to discuss the lack of response from the missions, and determine what steps both MCC and USAID can take to avoid this issue for future audits.

Recommendation No 3

We recommend that MCC Department of Compact Implementation and Division of Finance:

- Develop training for MCA Fiscal Agents to ensure proper reporting of re-disbursements on the QFRs to ensure the MCA is only requesting advances for immediate funding needs.

- Develop a tracking mechanism to monitor prepayments and to ensure that MCC and NBC personnel are properly reviewing the quarterly submitted QFRs for proper reporting of both the projected needs for advancement of funds and actual re-disbursements of previously advanced funds.

Management Response

MCC agrees with the recommendations. MCC has developed a report to monitor prepayments and will work with the National Business Center (NBC) to ensure that the first in/first-out method is followed when liquidating MCA advances. In addition, the FA Directors will provide training as needed to ensure that the MCAs provide accurate reporting of re-disbursements in their quarterly reporting submissions to MCC. MCC wishes to note that with the implementation of the Common Payment System (CPS), the use of advances is now limited to payment of MCA salaries and small dollar items. CPS makes payments directly to vendors via the US Treasury, eliminating the need for large dollar advances to MCA bank accounts.

Significant Deficiency 1: Quality Control Over Financial Reporting

We recommend that the MCC Division of Finance:

- Strengthen its quality control reviews over financial statements, notes, and other information presented, to ensure the information received is accurate, complete, and complies with accounting standards and reporting guidance.

- Increase communication with USAID to ensure information received has been reviewed and is reliable, in order for MCC to prepare complete and accurate financial statements in accordance with accounting standards and reporting guidance.

Management Response

MCC agrees with the recommendations. As noted in the audit report, MCC has made improvements in its quality control over financial report in FY 2009 (this item was a material weakness in FY 2008). In FY 2010, MCC will expand its review process to include quarterly fluctuation analysis of all materials accounts, review its reporting process to ensure that there is adequate time for an effective review process, and continue to coordinate with USAID on the timeliness and accuracy of financial data for the Threshold program.

Significant Deficiency 2: Controls Over Payroll Process

Recommendation No. 1: Untimely and Incomplete Processing of Separated Employees

We recommend that the MCC Division of HR:

- Ensure all HR personnel are aware of the requirement to document and retain the employee exit form in the OPF. In addition, direct HR personnel to obtain completed employee exit form from the Division of Security in a timely manner and document it properly in the employee's OPF.

- Direct HR personnel to follow up on all missing items when performing the OPF audits and completing the Purged OPF Check List.

- Develop and implement a process to monitor and ensure that HR and/or NBC personnel are completing leave audits as required and processing payments for amounts due to, or amounts owed by, separating employees on a timely basis.

Management Response

MCC agrees with the finding and recommendations. MCC's Human Resources division will establish procedures and controls to ensure that employee exit forms leave audits, and other requirements are met and filed in the OPF. MCC's HR division is undergoing a project to document all policies and procedures (develop or update as necessary) to ensure we are compliant with all federal requirements. These policies will include procedures and metrics where necessary to ensure we are complying with the policies. This project is scheduled to be complete by the end of November 2009.

Recommendation No 2: Improper and/or lack of certification on the SF-52/SF-50

We recommend that the MCC Division of HR:

- Review its current policies and procedures to ensure that proper authorization and approval of personnel actions are clearly documented on the required forms prior to processing.

- Direct HR personnel to adhere to the documented policies and procedures when preparing, reviewing, and approving personnel actions, to ensure reviews and approvals are properly documented.

- Provide the necessary training to responsible HR personnel to ensure that they are aware of the need for properly documenting reviews and approvals of personnel transactions.

Management Response

MCC agrees with recommendations. MCC's Human Resources division will establish procedures and controls to ensure proper personnel actions (SF-52/SF-50) documentation. MCC's HR division is undergoing a project to document all policies and procedures (develop or update as necessary) to ensure we are compliant with all federal requirements. These policies will include procedures and metrics where necessary to ensure we are complying with the policies. This project is scheduled to be complete by the end of November 2009.

Recommendation No 3: Lack of support for employee selected benefit deductions

We recommend that the MCC Division of HR:

- Establish a consistent tracking mechanism or other historical file for MCC employees to document all changes in employee benefits that are not documented using standard forms or Employee Express.

- Revise current policies and procedures to ensure that supporting documentation for all transactions processed by HR personnel on behalf of MCC employees are clearly documented either in the OPF or other historical file, and are readily available for examination.

Management Response

MCC agrees with the findings and recommendations. MCC's Human Resources Division will establish procedures and controls to ensure proper documentation of employee change requests. MCC will also discontinue the practice of accepting TSP changes via email. Employees will be required to use the appropriate form or Employee Express for changes to their TSP accounts. MCC's HR division is undergoing a project to document all policies and procedures (develop or update as necessary) to ensure we are compliant with all federal requirements. These policies will include procedures and metrics where necessary to ensure we are complying with the policies. Project is scheduled to be complete by the end of November 2009.

Significant Deficiency 3: Proper Reporting Period

We recommend that MCC Division of Finance:

- Continue to strengthen, and revise as necessary, policies and procedures for yearend accruals to ensure that all countries, types of funding, and programs are considered when recording estimates for future expenses, and that accruals are reasonably sufficient to cover anticipated costs.

- Establish and communicate procedures for the MCAs to require the submission of estimates or payment requests for current period expenses that have not, or will not be recorded until the subsequent year, for each fund type.

- Ensure that the accrual amount is adequately and reasonably calculated, clearly documented and supported, and properly reviewed for completeness and accuracy prior to and subsequently after posting to the GL.

- Ensure that USAID has procedures to resolve incorrect accruals and to make certain that quarterly and yearend amounts for the Threshold program are complete and accurate

Management Response

MCC agrees with the recommendations. MCC has implemented new formulation methodologies for its quarterly and year-end accruals that will ensure administrative; due diligence and program funds are accurately recorded. These new methodologies will be reflected in the update of MCC's financial management policy and procedures which will be released during the first quarter of FY 2010. MCC will meet with USAID management to discuss their procedures for ensuring that accruals reported as part of the quarterly reporting package to MCC are accurate and complete.

Significant Deficiency No 4: Fund Balance with Treasury (FBWT) Reconciliation

We recommend that the MCC Division of Finance:

- Inquire of USAID's procedures to resolve the issue of incomplete SF 224 reporting.

- Consider revisions to the Memorandum of Agreement (MOA) with USAID to require timely responses upon inquiry by MCC management regarding financial statement audit findings related to Threshold Program transactions.

Management Response

MCC agrees with the recommendations. MCC plans to meet with USAID management to discuss their plan of action to resolve this finding. MCC will update the MOU with USAID to require a copy of USAID's consolidated monthly reconciliation for the fund balance with Treasury as part of our oversight Threshold reporting. MCC's ability to implement the recommendation with regard to USAID will be dependent on their agreement to the terms of the MO, and their timely completion of FBWT reconciliations s in accordance with established Treasury guidelines.

FINANCIAL SECTION

In accordance with the OMB Circular A-136, Financial Reporting Requirements, MCC's financial statements are in the appropriate form and content for FY 2009. The tables below outline the following financial statements:

- Balance Sheets;
- Statements of Budgetary Resources;
- Statements of Net Cost;
- Statements of Changes in Net Position;
- Notes to Financial Statements; and
- Independent Auditor Reports of the MCC's Financial Statements, Internal Controls, and Compliance for the period ending September 30, 2009 and 2008.

BALANCE SHEETS

	FY 2009	FY 2008
Assets		
Intra-Governmental		
Fund Balance with Treasury *(Note 2)*	**$6,655,511,983**	**$6,546,857,481**
Advances *(Note 5)*	6,474,444	9,485,386
Total Intra-Governmental	**6,661,986,427**	**6,556,342,867**
Accounts Receivable, Net *(Note 3)*	90,363	54,672
General Property, Plant, and Equipment, Net *(Note 4)*	6,953,153	8,127,205
Advances *(Note 5)*	32,422,386	33,093,266
Total Assets	**$6,701,452,329**	**$6,597,618,010**
Liabilities		
Intra-Governmental		
Accounts Payable *(Note 1F)*	229,546	4,973
Contributions and Payroll Taxes Payable	467,304	376,093
Total Intra-Governmental	**696,850**	**381,066**
Federal Employee and Veteran Benefits Payable	35,751	0
Accounts Payable *(Note 1F)*	56,026,101	35,343,643
Accrued Funded Payroll Liabilities	7,196,040	6,444,041
Total Liabilities	**$63,954,742**	**$42,168,750**
Net Position		
Unexpended Appropriations – Other Funds	$6,632,548,466	$6,548,610,190
Cumulative Results of Operations – Other Funds	4,949,121	6,839,070
Total Net Position	**$6,637,497,587**	**$6,555,449,260**
Total Liabilities and Net Position	**$6,701,452,329**	**$6,597,618,010**

The notes are an integral part of these financial statements.

STATEMENTS OF BUDGETARY RESOURCES

	FY 2009	FY 2008
Budgetary Resources		
Unobligated Balance – Beginning of Period	$962,304,024	$2,256,142,503
Recoveries of Prior Years Obligations	1,029,114	504,898
Budget Authority:		
Appropriations	875,000,000	1,557,000,000
Nonexpenditure Transfers, Net, Anticipated and Actual	(679,000)	(10,810,404)
Permanently Not Available *(Note 8)*	0	(70,611,700)
Total Budgetary Resources	**$1,837,654,138**	**$3,732,225,297**
Status of Budgetary Resources		
Obligations Incurred		
Direct	$1,050,551,545	$2,769,921,274
Unobligated Balance Available	56,176,028	780,796,905
Unobligated Balance Not Available	730,926,565	181,507,118
Total Status of Budgetary Resources	**$1,837,654,138**	**$3,732,225,297**
Change in Obligated Balance		
Obligated Balance, Net – as of October 1, 2008		
Unpaid Obligations, Brought Forward, October 1	$5,583,344,174	$3,287,907,145
Obligations Incurred	1,050,551,545	2,769,921,274
Gross Outlays	(764,670,301)	(473,979,346)
Recoveries of Prior Year Unpaid Obligations, Actual	(1,029,114)	(504,898)
Obligated Balance, Net – End of Period		
Unpaid obligations	$5,868,196,304	$5,583,344,174
Net Outlays		
Gross Outlays	$764,670,301	$473,979,346

The notes are an integral part of these financial statements.

STATEMENTS OF NET COSTS

Program	FY 2009	FY 2008
Program Costs *(Note 7)*		
Compact		
Gross Costs	$533,740,058	$226,498,265
Less: Earned Revenue	0	0
Net Program Costs	533,740,058	226,498,265
609 (g) Programs		
Gross Costs	15,693,976	9,768,972
Less: Earned Revenue	0	0
Net Program Costs	15,693,976	9,768,972
Threshold Programs		
Gross Costs	120,372,199	118,903,902
Less: Earned Revenue	0	0
Net Program Costs	120,372,199	118,903,902
Due Diligence Programs		
Gross Costs	28,922,102	17,338,771
Less: Earned Revenue	0	0
Net Program Costs	28,922,102	17,338,771
Audit		
Gross Costs	3,792,544	2,304,181
Less: Earned Revenue	0	0
Net Program Costs	3,792,544	2,304,181
Administrative		
Gross Costs	91,746,536	85,782,157
Less: Earned Revenue	0	0
Net Program Costs	91,746,536	85,782,157
Program Costs – Net of All Programs	**$794,267,415**	**$460,596,248**
Net Costs of Operations	**$794,267,415**	**$460,596,248**

The notes are an integral part of these financial statements.

STATEMENTS OF CHANGES IN NET POSITION

	FY 2009	FY 2008
Cumulative Results of Operations		
Beginning Balances	$6,839,070	$7,395,351
Adjustments		(1,671,357)
Beginning Balance, as Adjusted	6,839,070	5,723,994
Budgetary Financing Sources		
Appropriations Used	$790,382,685	$460,060,774
Other Financing Sources		
Donations and Forfeitures of Property *(Note 1P)*	205,266	0
Imputed Financing	1,789,515	1,650,550
Total Financing Sources	792,377,466	461,711,324
Net Cost of Operations	(794,267,415)	(460,596,248)
Net Change	(1,889,949)	1,115,076
Cumulative Results of Operations	**$4,949,121**	**$6,839,070**
Unexpended Appropriations		
Beginning Balance	$6,548,610,190	$5,536,714,361
Adjustments	0	(3,621,292)
Correction of errors	(39)	0
Beginning Balance, as Adjusted	$6,548,610,151	$5,533,093,069
Budgetary Financing Sources		
Appropriations Received	$875,000,000	$1,557,000,000
Appropriations Transferred In/Out	(679,000)	(10,810,404)
Other adjustments *(Note 8)*	0	(70,611,700)
Appropriations Used	(790,382,685)	(460,060,774)
Total Budgetary Financing Sources	83,938,315	1,015,517,122
Total Unexpended Appropriations	**$6,632,548,466**	**$6,548,610,190**
Net Position	**$6,637,497,587**	**$6,555,449,260**

The notes are an integral part of these financial statements.

Notes to Financial Statements (As of September 30, 2009)

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, as amended, 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.

MCC's principle financial statements are:

- Balance Sheet;
- Statement of Net Cost;
- Statement of Budgetary Resources; and
- Statement of Changes in Net Position.

Financial statement footnotes are also included and 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, as amended, (Public Law 108-199). MCC's mission is to reduce poverty by supporting sustainable, transformative economic growth in developing countries that create and maintain sound policy environments. Assistance is intended to provide economic growth and alleviate 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 has attained total appropriations of $875 million and $1.557 billion in FY 2009 and FY 2008, 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 and audit oversight, compact programs, due diligence programs, 609(g) programs and threshold programs. MCC does not have any earmarked 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 the Treasury; however, unobligated balances as of September 30 for these three categories of funds are transferred to the program 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. In order to appropriately depict a comparable analysis of FY 2008 activity, MCC reclassified its Federal accounts payable balances separately from its non-Federal balances. Accounts payable reported at the end of FY 2009 were $56 million (non-Federal) and $230K (Federal) and at the end of FY 2008 were $35.3 million (non-Federal) and $5K (Federal).

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 MCC 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 2009 and FY 2008.

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 adjusted the FY 2009 beginning balance for unexpended appropriations by $39 to account for an error correction.

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 seven 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 one percent of basic pay to TSP and matches employee contributions up to an additional four percent of pay, for a maximum MCC contribution amounting to five percent of pay.

Employees under CSRS may participate in the TSP, but will not receive either MCC's automatic or matching contributions.

As of the end of FY 2009, MCC made retirement contributions of $116,000 to CSRS, $2.58 million to FERS, and $1.01 million 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 Liabilities

Under current policy and procedures, MCC disburses funds for Compact and pre-Compact projects and activities upon the presentation of a valid invoice. However, under certain conditions, MCC will fund countries by advancing funds on an as-needed basis to cover basic 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 by the MCA and is then returned to the Treasury's general funds. MCC received and deposited $213,000 and $1.61 million in interest remittances as of September 30, 2009 and 2008, respectively. This reduction of interest remittances is due to the full implementation of ITS with all MCC partner countries.

P. Donated Services

MCC may on occasion utilize donated services from other Federal agencies, individuals and private firms in the course of business operations. The approximate fair market value of donated services for September 30, 2009 was $205,266. MCC did not utilize donated services for FY 2008.

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, apportionments are derived.

MCC allocates funds, as the parent, to USAID. In FY 2009 and FY 2008, MCC transferred budgetary authority of $33 million and $110 million, respectively, to USAID to administer Threshold and Compact programs. USAID receives these allocations as transfers-in and reports quarterly to MCC as the child. MCC also transfers an administrative fee to USAID for the purposes of administering the Threshold and Compact programs. Since FY 2008, these administrative fee transfers are not reported back to MCC.

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 theses balances in the Fund Balance with Treasury. The general fund line items on the Balance Sheet for September 30, 2009 and 2008 consisted of the amounts presented in **Exhibit 13**. The status of the general fund balances is summarized by obligated, unobligated and Non-Budgetary fund balances in **Exhibit 14**.

Exhibit 13: Fund Balance with Treasury as of September 30

	September 30, 2009 (in thousands)	September 30, 2008 (in thousands)
Fund Balances		
General Funds	$6,655,512	$6,546,857
Total	**$6,655,512**	**$6,546,857**

Exhibit 14: Status of Fund Balance with Treasury as of September 30

	September 30, 2009 (in thousands)	September 30, 2008 (in thousands)
Status of Fund Balance with Treasury		
Unobligated Balance Available Unavailable	 $56,176 730,927	 $782,006 181,507
Obligated Balance	$5,868,196	$5,583,344
Non-Budgetary FBWT	213	
Total	**$6,655,512**	**$6,546,857**

Note 3—Accounts Receivable, Net

Accounts receivable reflect overpayments of payroll, travel and other MCC current and former employee expenses. It also reflects substantiated disallowed MCA expenditures. MCC does not record an allowance for doubtful accounts as these expenses are deemed wholly collectible. Total receivables as of the end of FY 2009 and FY 2008 were approximately $90,000 and $55,000, respectively.

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 for both FY 2009 and FY 2008 was $10.9 million. Accumulated depreciation was approximately $4.0 million and $2.8 million, respectively. The current book value is $6.95 million and $8.1 million for the periods ending September 30, 2009 and 2008, respectively. The useful life of the improvements is based on the lease terms: ten years for the Bowen building lease and eight 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 five 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 five 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 three years or more. These Thresholds reduce MCC's administrative costs associated with accounting for PP&E, and result in increased operational efficiency.

Note 5—Advances

Advances reflect amounts provided to Compact countries and other Federal agencies in accordance with formal Compacts or inter-agency agreements. In order to appropriately depict a comparable analysis of 2008 activity, MCC reclassified its Federal advances separately from its non-Federal balances. MCC reported $38.9 million ($6.5 million, Federal and $32.4 million, non-Federal) and $42.6 million ($9.5 million, Federal and $33.1 million, non-Federal) in advances as of September 30, 2009 and 2008, respectively.

NOTE 6—LEASES

MCC leases office space in two adjacent locations in Washington, D.C. These operating leases are on ten year (Bowen Building) and eight year (City Center Building) lease terms that terminate on May 25 and May 26, 2015, respectively. The Bowen building lease increases approximately one percent each year of the lease term. The City Center building lease increases at a fixed level every three years until the termination of the lease.

MCC also has short term leases for one (1) corporate vehicle (through May 31, 2010) and for eighteen (18) office copier machines (through January 31, 2012) utilized in both buildings. The future lease payments due are depicted in the **Exhibit 15** below.

Exhibit 15: Operating Leases

Future Lease Payments Due (in dollars)			
Fiscal Year	**Bowen**	**City Center**	**Total**
FY 2010	5,557,542	1,889,524	7,447,066
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
FY 2014	5,783,201	1,995,229	7,778,430
FY 2015	5,841,033	1,995,229	7,836,262
Total Future Lease Payments	**$34,190,083**	**$11,707,110**	**$45,897,193**
Future Lease Payments Due (in dollars)			
Fiscal Year	**MCC Vehicle**	**MCC Copiers**	**Total**
FY 2010	5,009	55,821	60,830
FY 2011	0	55,821	55,821
FY 2012	0	55,821	55,821
Total Future Lease Payments	**$5,009**	**$167,463**	**$172,472**

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 funded programs. **Exhibit 16** shows the value of exchange transactions between MCC 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 relate to transactions between the MCC and non-Federal entities. MCC does not have any exchange revenues.

Exhibit 16: Intra-governmental Costs and Exchange Revenue (in thousands)

	Compact	609(g)	Threshold	Due Diligence	Audit	Administrative	FY 2009 Total (in thousands)	FY 2008 Total (in thousands)
Intra-Governmental	16	-	5,683	6,601	2,022	14,512	28,834	19,089
Public	533,724	15,694	114,689	22,321	1,771	77,234	765,433	441,507
Total - Program	**$533,740**	**$15,694**	**$120,372**	**$28,922**	**$3,793**	**$91,746**	**$794,267**	**$460,596**

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 was not subject to any rescissions in FY 2009.

Note 9—Explanation of Differences between the Statement of Budgetary Resources 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 for FY 2008 and the FY 2008 actual data reported in the President's 2010 budget submission. Fiscal year 2009 actual data will be published in February 2010 within the 2011 Budget of the United States. No material differences were noted.

Note 10—Undelivered Orders at the End of the Period

Exhibit 17 presents Undelivered Orders, paid and unpaid, as of September 30, 2009 and 2008.

Exhibit 17: Undelivered Orders

Undelivered Orders	2009	2008
Administrative	27,268,537	27,302,437
Audit	1,131,689	2,180,340
609(g)	42,422,624	25,349,832
Due Diligence	60,123,947	49,203,177
Program	5,563,885,135	5,242,750,204
Threshold	148,518,787	238,174,754
Total	**$5,843,350,719**	**$5,584,960,744**

NOTE 11—RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

Exhibit 18 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 18: Reconciliation of Net Cost of Operations to Budget

Resources Used to Finance Activities		Program Costs	
Budgetary Resources Obligated			
Obligations Incurred	1,050,551,545	**Gross Costs**	794,267,415
Recoveries of prior year unpaid obligations	(1,029,114)		
Other financing resources	1,994,782		
Total resources used to finance activities	1,051,517,213		
Total resources used to finance items not part of the net cost of operations	(258,466,266)	**Less: Earned Revenue**	-
Total components of net cost of operations that will not require or generate resources	1,216,468		
Net Cost of Operations	**$794,267,415**	**Net Cost of Operations**	**$794,267,415**

Summary of Financial Statement Audit and Management Assurances

In accordance with the requirements of OMB Circular A-136, MCC is required to prepare a summary of its financial statement audit. The FY 2009 Independent Auditor's report cited one material weakness in MCC's controls over mission activities and support. MCC resolved its FY 2008 material weakness. **Exhibit 19** provides a summary of the status of MCC Financial Statement Audit Material Weaknesses.

Exhibit 19: Summary of Financial Statement Audit

Audit Opinion	**Unqualified**				
Restatement	**No**				
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Quality Control Over Financial Reporting	1	-	1	-	0
Controls over Mission Activities and Support	0	1	-	-	1
Total Material Weaknesses	**1**	**1**	**1**	**-**	**1**

Office of Inspector General

Mr. Darius Mans
Acting Chief Executive Officer
Millennium Challenge Corporation
875 15th Street, NW
Washington, DC 20005

November 16, 2009

Dear Mr. Mans:

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

The Reports Consolidation Act of 2000 (Public Law 106–531) requires that agency performance and accountability reports include a statement prepared by each agency's inspector general, summarizing the most serious management and performance challenges facing the agency and reporting the agency's progress in addressing those challenges. The enclosed statement will be included in MCC's fiscal year 2009 performance and accountability report or agency financial report.

We have discussed the management and performance challenges summarized in this statement with the responsible MCC officials. If you have any questions or wish to discuss the statement further, please contact me or Alvin Brown, the Assistant Inspector General for MCC.

Sincerely,

Donald A. Gambatesa /s/
Inspector General

Enclosure

U.S. Agency for International Development
1300 Pennsylvania Avenue, NW
Washington, DC 20523
www.usaid.gov/oig

Statement by the Office of Inspector General on the Millennium Challenge Corporation's Most Serious Management and Performance Challenges Fiscal Year 2009

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

- MCC Suspended, Terminated, and Canceled Planned Compact Activities
- Threshold Programs for Compact Eligibility
- Financial Management
- Information Technology Management

For fiscal year (FY) 2009, the Office of Inspector General (OIG) is reporting "MCC Suspended, Terminated, and Canceled Planned Compact Activities" and "Threshold Programs" as serious management and performance challenges for the first time. OIG initially reported challenges in the "Financial Management" and the "Information Technology Management" areas in FY 2008. While MCC has made some improvements in the areas of financial management and information technology management, both continue to represent serious management challenges for MCC.

We had reported "Implementation of Compacts" as a serious management challenge for MCC in FY 2008. At that time, MCC was experiencing serious management challenges due to the low rate of disbursements and the increasing costs associated with infrastructure projects. MCC has increased its rate of disbursements through the implementation of a new compact development process. As a result of these improvements, we have not included "Implementation of Compacts" as a serious management challenge for FY 2009. OIG will continue to monitor the implementation of compacts.

MCC Suspended, Terminated, and Canceled Planned Compact Activities

In 2009, MCC suspended, terminated, or canceled a total of $340 million in planned activities in 5 of the 19 compact countries because of political unrest in and around those countries. MCC has suspended or terminated activities because of the removal of democratically elected leaders (in two cases) and patterns of undemocratic actions involving the 2008 elections (in two other cases). As a result, activities totaling $152 million were terminated. In another case, a neighboring country would not allow the compact country to meet the compact requirements, which resulted in the cancellation of a $188 million project. During FY 2009, MCC has suspended, terminated, or canceled compact activities in the following countries:

- **Madagascar.** On March 17, 2009, Madagascar removed its democratically elected president from office. MCC's board determined that the nature of the actions taken represented a pattern of actions inconsistent with MCC's eligibility indicator for the

"Ruling Justly" category. As a result, MCC placed an operational hold on activities on March 20, 2009. The compact was terminated on August 31, 2009. As a result, MCC will deobligate $21 million to $23 million.

- **Honduras.** On June 28, 2009, Honduras removed its democratically elected president from office. The Government of Honduras (GOH) failed to address concerns regarding its commitment to democracy. MCC continued to assist the GOH with an agricultural irrigation project to maintain poverty reduction for the rural poor. In September 2009, the MCC board terminated a component of a rural roads rehabilitation project that had not yet begun, which resulted in a reduction of $11 million (approximately 5 percent) of the initial compact.

- **Nicaragua.** Because of a pattern of undemocratic actions involving elections in late 2008, MCC partially terminated its compact with Nicaragua. In February 2009, the MCC board voted to terminate funding for a property regularization project implemented by the Government of Nicaragua and for a major road rehabilitation activity that had not begun. MCC will complete the projects that were underway, including rehabilitation of roads that were already under contract and rural business development projects that have a direct impact on the rural poor. As a result of the termination, the total assistance was reduced by approximately $61 million (approximately 35 percent) of the initial compact of $175 million.

- **Armenia.** Because of a pattern of undemocratic actions involving elections in early 2008, MCC placed an operational hold on a rural roads rehabilitation project. The MCC board confirmed the operational hold in February 2009. MCC will continue the irrigated agriculture project to maintain poverty reduction for the rural poor. At this late stage in the compact, it will be impossible to restart the rural roads rehabilitation project. Accordingly, the initial compact amount of $235 million will be reduced by $59 million (approximately 25 percent).

- **Mongolia.** On April 27, 2009, the Government of Mongolia officially notified MCC of its need to cancel a rail project that had accounted for $188 million of the $285 million compact. The rail project was canceled because the Russian members of UBTZ, the joint Mongolian-Russian rail company, would not allow an audit of the company to proceed. Although MCC is considering alternative projects to fund in Mongolia, it has told the Government of Mongolia that there is no guarantee that all of the funds will remain in the compact.

The actions mentioned above represent very serious management challenges that will persist because of the nature of MCC's mission. MCC has established a set of indicators that a country must meet in order to become eligible for a compact. However, because MCC operates in the dynamic environments of developing countries, the political environment will be an ongoing management challenge as compacts are carried out over a 5-year period.

Threshold Programs for Compact Eligibility

As stated in our audit of the Threshold Program (M-009-003-P, April 29, 2009), MCC had provided about $440 million in funding for threshold programs to assist 12 countries to become compact eligible. However, we found no clear indication that the MCC Threshold Program was assisting countries in becoming compact eligible. For example:

- Eight of the 12 countries that will complete threshold programs as of the end of FY 2009 became compact eligible before completing their threshold programs (for those completed by the end of FY 2009). Three of the eight countries became eligible as early as 1 month before or after their threshold program started.

- Three of the 12 countries did not become compact eligible. Two of the three countries did not become eligible after completing their first threshold programs; instead, MCC approved another threshold agreement (stage II).

- One of the 12 countries received compact assistance about 11 months before its threshold program ended.

Some countries have also become compact eligible and received compacts without participating in the Threshold Program. MCC measured the program results by changes in the countries' "Control of Corruption" indicator scores, but the changes were not clearly attributable to MCC's efforts. MCC is reviewing the Threshold Program to determine whether the existing program can achieve the objective of helping countries become compact eligible.

Financial Management

For FY 2009—the sixth consecutive year—OIG has issued unqualified opinions on MCC's FY financial statements. Notwithstanding these unqualified opinions and the progress that MCC has made in establishing and maintaining financial management processes, MCC's quality control over quarterly and yearend financial reporting is not sufficient to enable it to detect errors and misstatements and to make corrections in a timely manner. MCC does not perform sufficiently detailed quality-control reviews over yearend MCC trial balances and financial statements submitted for review and audit.

The vast majority of MCC's activities and expenses occur in the compact and threshold programs. These programs are implemented by MCC's Millennium Challenge Account (MCA) entities and USAID's overseas missions. MCC did not adequately monitor these organizations' ongoing activities or the financial information being reported on its own financial statements. The MCA entities responsible for implementing the compact programs, as well as the USAID missions responsible for implementing MCC's threshold programs, did not respond adequately to requests for supporting documentation for expenses reported to MCC. During our audit, we noted the following weaknesses:

- **MCA Audits Lack Timely Completion and Monitoring.** Audits performed by independent auditors of the controls, transactions, and balances of MCA entities have not been completed and submitted to OIG in a timely manner. In addition, MCC has not monitored the start and completion of these audits adequately to ensure a timely submission of audit reports and notification of findings. This situation increases MCC's risk of not being informed of MCA entity activities that would affect timely preparation of financial statements.

  To ensure sufficient internal control over the MCA entities, MCC requires semiannual audits to be conducted for the 6-month periods ending in June and December of each year. The audit results assure MCC of the validity and accuracy of payments and advances that are processed for the MCA entities and reported in its financial statements. This assurance is needed because neither MCC nor its accounting service provider, the U.S. Department of Interior's National Business Center, reviews or maintains invoices and other underlying supporting documentation for transactions. Instead, MCC relies on approved request documents submitted by personnel of the MCA entity.

- **Transactions Lack Adequate Documentation.** MCA entities and threshold missions did not provide or respond to requests for supporting documentation in a timely manner for all expenses and undelivered orders. The audit team informed MCC that, prior to yearend testing, documentation would be requested from MCA entities and threshold missions to substantiate yearend balances and that responses would be required within 5 days to meet tight audit deadlines. This detailed written information was communicated to all points of contact for MCA entities and USAID threshold missions.

  Upon submission of the supporting documents, some MCA entities and threshold missions responded in a timely manner, but others provided incorrect or insufficient documentation or none at all. MCC was advised of the lack of responses and in turn sent several emails to MCA entities and threshold missions requesting their cooperation. However, significant numbers of transactions remained unsupported at the conclusion of audit fieldwork. These issues were raised, and recommendations made, in the audit of MCC's FY 2009 Financial Statements (M-000-010-001-C, November 16, 2009).

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

Information Technology Management

Although MCC has made improvements to strengthen its information security program, it is still not fully compliant with the key components of the Federal Information Security Management Act of 2002 (FISMA). FISMA requires agencies to (1) develop, document, and implement agencywide information security programs to protect their information and information systems, including those provided or managed by another agency, contractor, or other source; (2) obtain an annual independent evaluation of information security programs and practices; and (3) assess compliance with the requirements of the act. Although MCC is making progress in complying with these requirements, weaknesses remain.

MCC developed and implemented a comprehensive plan that addressed all but one of the FY 2008 FISMA audit findings. However, the FY 2009 FISMA audit found several areas in which MCC needs to strengthen existing policies and develop procedures to fully comply with requirements of the National Institute of Standards and Technology and the Office of Management and Budget. MCC noted that it has a comprehensive plan to address all of the FY 2009 FISMA audit findings by April 2010.

MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Memorandum

TO: Alvin A. Brown
Assistant Inspector General

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

DATE: November 13, 2009

SUBJECT: Management Response to Statement by the Office of Inspector General (OIG) on the MCC's Most Serious Management and Performance Challenges Fiscal Year 2009

We wish to thank the OIG for their recognition of the progress the MCC has made in its implementation of compacts and our efforts to increase the disbursement rates. In its FY 2009 Statement of MCC's Most Serious Management and Performance Challenges, the OIG notes four items:

- MCC Suspended, Terminated, and Canceled Planned Compact Activities
- Threshold Programs for Compact Eligibility
- Financial Management
- Information Technology Management

We agree with OIG's assessment that the unpredictable political environment in our partner countries will be an ongoing challenge for management and the MCC Board of Directors. One of MCC's founding principles is that aid is most effective when it reinforces good governance. MCC will continue to abide by this principle as we deal with current and future political challenges.

The Threshold program has a portfolio of 21 programs, several of which have recently concluded. Due to the varying breadth of activities, countries and implementers, we are reviewing the program, its intentions, and measures of success. A full report will be presented to the MCC Board in FY 2010.

We also agree with the OIG's FY 2009 audit findings and recommendations related to financial management. While MCC has received unqualified audit opinions since inception and has made great progress in establishing its financial management environment, we acknowledge that further improvement is needed.

In FY 2010, we will focus on increased quality control both internally, and with our implementing partners in compact countries and at USAID.

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