# 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, 2010 AND 2009

AUDIT REPORT NO. M-000-11-001-C
November 15, 2010

WASHINGTON, DC

*Office of Inspector General*
*for the Millennium Challenge Corporation*

November 15, 2010

Mr. Daniel Yohannes
Chief Executive Officer
Millennium Challenge Corporation
875 15th Street, NW
Washington, DC 20005-2221

Subject: Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Periods Ending September 30, 2010 and 2009
Report No. M-000-011-001-C

Dear Mr. Yohannes,

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, 2010. 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.*

The Independent Auditors expressed a qualified opinion on MCC's FY 2010 and 2009 Financial Statements. The report stated that the auditors discovered certain errors during the audits of the current year that resulted in understatements of previously reported advances as of September 30, 2009. Consequently, the financial statements as of September 30, 2009 were restated to reflect corrections to previously reported advances and the related effect on expenses.

The report also stated that MCC's process for compiling accruals was not comprehensive enough to record accruals for material amounts of current-year expenses not paid or invoiced until the subsequent period. While additional procedures were performed to compile such information for the FY 2010 statements, these procedures did not extend to FY 2009, which in the independent auditors' opinion, should have been included in accordance with accounting procedures generally accepted in the United States of America. FY 2009 expenses were understated by accrual amounts, and FY 2010 expenses were overstated by those same amounts.

In their opinion, except for the effects of insufficiently accruing for expenses reported in a subsequent period, as discussed in the preceding paragraph, MCC's financial statements for FY 2010 and FY 2009 present fairly, in all material respects, the financial position of MCC as of September 30, 2010 and 2009, and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of an entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Cotton & Company , LLP reported the following deficiencies in MCC's internal control to be material weaknesses and the cause of qualified opinion:

1. Reporting Advance Payments.
2. Compiling Accruals (Proper Reporting Period).
3. Monitoring Controls over Millennium Challenge Accounts Activities.

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.

The auditors considered the following deficiencies in MCC's internal control to be significant deficiencies.

1. Reconciling Fund Balance with Treasury
2. Controls over Financial Reporting

The auditors did not note any instances of material non-compliance with laws and regulations.

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 were 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 15, 2010, 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 10, 2010.

**Material Weaknesses**

**Reporting Advance Payments**
We recommend that the MCC Division of Finance and Department of Compact Operations:

**Recommendation No. 1:** Modify the Payment Request Form (PRF) to specifically identify requests for advance payments to vendors.

**Recommendation No. 2:** Provide training to Fiscal Agents and other in-country personnel to explain how to properly record each line of the PRF based on supporting documents and how MCC financial statements are affected by MCA activities and transactions.

**Compiling Accruals (Proper Reporting Period)**
We recommend that MCC Division of Finance revise and strengthen its process for determining accruals required at yearend by implementing the following:

**Recommendation No. 3:** Establish a comprehensive methodology and/or standard process for obtaining, recording, and reporting yearend accruals which covers all MCAs and funds and include invoiced and rendered services which have not been recorded in the yearend trial balance.

**Recommendation No. 4:** Establish consistent communication with NBC and the MCAs for understanding the process and methodology developed.

**Recommendation No. 5:** Perform quality control procedures over amounts obtained and recorded. Review the amounts posted for reasonableness, accuracy, and completeness.

**Monitor Controls over MCAs Activities**

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

**Performance of Timely and Complete MCA Audits**
**Recommendation No. 6:** Implement a process for coordinating with MCAs, audit firms, and the OIG to ensure all parties are adequately informed of the progress of all audits to ensure that MCA audits are completed in accordance with the compact.

**Recommendation No. 7:** Establish and implement a process to ensure that MCAs prepare and make available for audit the status of advances to contractors, retention balances and data necessary for MCC to properly report its accruals.

**Improper and Untimely Quarterly Reporting**
We recommend that MCC Management and Department of Compact Operations:

**Recommendation No. 8:** Establish and implement a process to ensure that all personnel responsible for QFRs to guide them to submit accurately prepared and properly approved QFRs and Disbursement Requests in a timely manner.

**Recommendation No. 9:** Establish and implement a process to ensure that funds are periodically reviewed to determine if MCAs should submit final QFRs to record deobligations for funds no longer needed.

**Inadequate Oversight of 609(g)-Funded Transactions**

**Recommendation No. 10:** We recommend that MCC Department of Compact Operations coordinate with appropriate management levels to implement a formal process for administering 609(g) funds in all countries not managed by either MCC or an MCA.

**Recommendation No. 11:** We recommend that MCC Department of Compact Operations, in coordination with the Division of Finance monitor on a quarterly basis the cumulative obligation and disbursements of all countries that have received 609(g) funds and communicate with the MCAs to determine if there is still an immediate need to maintain excess 609(g) funds that have not been disbursed. The input from MCC Department of Compact Operations must be documented. Deobligate 609(g) funds that are no longer considered an immediate need to the MCA/Partnering Country.

**Recommendation No. 12:** We recommend that MCC Department of Compact Operations strengthen its CPS Signature Card process to include a MCC authorizing signature, effective and termination dates, to include an annual or other periodic review process between MCC, its financial service provider, and the MCAs to ensure that signature cards are kept on file for only active users of its CPS payment requesting system.

**Inadequate Processing of Closed Programs:**
We recommend that the MCC management and Department of Compact Operations:

**Recommendation No. 13:** Develop policies and procedures for Program Closure of Compacts that have been suspended or terminated to ensure that programs, activities, and assets are properly accounted for, and final disposition is reported to MCC.

**Recommendation No. 14:** Establish guidelines for Fiscal Accountability Directors, Fiscal Agents, as well as personnel in the Division of Finance and MCC's financial services provider to make them fully aware of any restrictions to process payments made during a program or compact close-out period.

**Significant Deficiencies**

**Reconciling Fund Balance with Treasury**
**Recommendation No. 15:** We recommend that the MCC Division of Finance continue to follow USAID's progress toward elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC's risk of potential misstatements.

**Control over Financial Reporting:**
We recommend that the MCC Division of Finance:

**Recommendation No. 16:** Strengthen its quality reviews over financial statements to validate that information presented is accurate, complete, and complies with accounting standards and reporting guidance.

**Recommendation No. 17:** Establish quality control procedures to document during the review process any discrepancies, errors, and other anomalies that have occurred to provide an audit trail of issues that may require on-top adjustments.

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 been reached on all 17 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 at (202) 216-6962, if you have any questions concerning this report.

Sincerely,

/s/
Alvin A. Brown
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, 2010 and 2009, 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 audits.

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) audit guidance. These standards require that we plan and perform the audits 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.

As more fully described in Note 10 to the above-referenced statements, we discovered certain errors during our audits of the current year that resulted in understatements of previously reported advances as of September 30, 2009. Accordingly, the Balance Sheet as of September 30, 2009, and related Statements of Net Cost, Changes in Net Position, and Budgetary Resources for the year then ended have been restated to reflect corrections to previously reported advances and the related effect on expenses.

In addition, MCC's process for compiling accruals was not comprehensive enough to record accruals for material amounts of current-year expenses not paid or invoiced until the subsequent period. While additional procedures were performed to compile such information for the FY 2010 statements, these procedures did not extend to FY 2009, which, in our opinion, should have been included in accordance with accounting principles generally accepted in the

United States of America. FY 2009 expenses were understated by accrual amounts, and FY 2010 expenses were overstated by those same amounts.

In our opinion, except for the effects of insufficiently accruing for expenses reported in a subsequent period, as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of MCC as of September 30, 2010 and 2009, and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information in the Management's Discussion and Analysis (MD&A) and Other Accompanying Information sections is not required as part of the basic financial statements. 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 audits. 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 15, 2010, 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 15, 2010
Alexandria, Virginia

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**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL**

We have audited the Balance Sheets of the Millennium Challenge Corporation (MCC) as of September 30, 2010 and 2009, 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 15, 2010. 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) audit guidance.

In planning and performing our audits of MCC's financial statements as of and for the years ended September 30, 2010 and 2009, in accordance with auditing standards generally accepted in the United States of America, we considered MCC's internal control over financial reporting (internal control) as a basis for designing our auditing 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 MCC's internal control. Accordingly, we do not express an opinion on the effectiveness of MCC's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of an entity's financial statements will not be prevented, or detected and corrected on a timely basis.

We consider the following deficiencies in MCC's internal control to be material weaknesses.

3. **Reporting Advance Payments.** MCC improperly recorded advance payments as expenses and therefore did not perform appropriate liquidation procedures. These errors resulted in expenses being overstated by material amounts in the current and prior fiscal years. As a result, Fiscal Year (FY) 2009 financial statements were restated.

4. **Compiling Accruals (Proper Reporting Period).** MCC's process for compiling accruals was not comprehensive enough to sufficiently accrue for material amounts of current-year expenses that were not paid or invoiced until the subsequent period. While additional procedures were performed to compile such information for the FY 2010 statements, these procedures did not extend to FY 2009. This caused FY 2009 statements to be understated by accrual amounts, and FY 2010 statements to be overstated by those same amounts.

5. **Monitoring Controls over MCA Activities.** MCC lacks sufficient controls over mission activities to ensure timely and accurate reporting of transactions and balances. We noted untimely completion of Millennium Challenge Account (MCA) audits, inadequate oversight of 609(g) funds, untimely quarterly reporting, and inadequate processing of closed programs. The combination of these weaknesses increases MCC's risk of inaccurate, incomplete, and untimely reporting of MCA activities.

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.

We consider the following deficiencies in MCC's internal control to be significant deficiencies.

6. Reconciling Fund Balance with Treasury

7. Controls over Financial Reporting

**MATERIAL WEAKNESSES**

**1. REPORTING ADVANCE PAYMENTS**

MCA coded prepayments to vendors as expenses instead of as advances. During our tests of controls over 87 expense transactions recorded in MCC's general ledger as of June 30, 2010, we identified three MCAs that submitted a total of seven invoices for "expense" payments to vendors rather than correctly reporting them as "advance" payments for future expenses. These seven transactions totaled $40 million. We expanded audit tests to include all MCAs to identify other such instances. Results of those tests revealed that MCAs submitted $216 million in advance payments to vendors since FY 2008. Of this, $60 million has been liquidated based on services provided to date.

Advance payments from MCAs are to be reported by an indication on the Payment Request Form (PRF) with a project and activity code of "NA NA." Related liquidations of those advances are to be reported quarterly on the Quarterly Financial Report (QFR). MCAs are aware that these payments are advances; supporting invoices clearly indicate "pre-payment/advance," and MCAs track such information in their own accounting records. It appears, however, that MCAs code payments as regular expenses on PRFs, because specific project and activity codes were known at the time of the advance, and payments were sent directly to vendors versus MCA's permitted account. This practice was started when the Common Payment System (CPS) was instituted, and payments could be submitted directly to vendors. Before this, all funds were provided to MCAs as an advance.

Improper recording of advance payments and lack of appropriate liquidation caused expenses to be overstated by $18 million, $53 million, and $83 million in FYs 2008, 2009, and 2010, respectively. To correct these errors, MCC has restated its FY 2009 financial statements for the effects of both FY 2008 and 2009 and made appropriate adjustments to the FY 2010 financial statements.

**Recommendation.** We recommend that the MCC Division of Finance and Department of Compact Operations:

- Consider modifying the PRF to specifically identify requests for advance payments to vendors.

- Provide training to Fiscal Agents and other in-country personnel to explain how to properly record each line of the PRF based on supporting document and how MCC financial statements are affected by MCA activities and transactions.

## 2. COMPILING ACCRUALS (PROPER REPORTING PERIOD)

MCC's process for compiling accruals was not comprehensive enough to sufficiently accrue for significant current year expenses. As a result, expenses for goods and services received and performed were not recorded in the proper period. This is a repeat finding from previous-year audits, which cited that MCC's accrual processes were not sufficient to identify and compute amounts owed, but not paid, in the appropriate period. In FY 2010, MCC continued its process of contacting its vendor, National Business Center (NBC), for a listing of invoices and payment requests received but not paid, and requested that the information include the first 12 days of FY 2011.

During our review of accruals recorded at yearend, we noted that some payment requests made on or before October 12, 2010 were not accrued, and other significant payments were requested within a few days of October 12, 2010. We determined that these payments were for FY 2010 services. Based on our sample testing, we identified unrecorded accruals for FY 2010 expenses reported in FY 2011 that resulted in understated expenses for compact funds of $11 million in known amounts and $873,000 in likely amounts. In addition, our review noted that accruals were not recorded for anticipated expenses incurred but not yet invoiced, payments made to U.S. vendors, 609(g) and Compact Implementation Funds (CIF), compact funds for two MCAs, and liquidations of advances for two additional MCAs.

Also, MCC retained amounts withheld from vendor payments on large construction-type contracts in its compact countries. MCC was unaware of these retained amounts being held and the need to record them as expenses incurred in the year of retention. Because these retained fees were incurred at the time of invoicing, but not paid until a later date, an accrual must be recorded to match the expense with the period in which it was incurred. With respect to retained fees that should have been accrued for invoices received as of September 30, 2010, we noted that expenses were understated by $26 million in FY 2010. The FY 2009 amount accrued should have been $9 million.

Statements of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government* (Paragraphs 22 and 23), states:

> *…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.*

Further, OMB Circular A-136, *Form and Content of the Performance and Accountability Report (PAR)*, *Balance Sheet,* Section III.3.4, *Liabilities,* states that:

> *…liabilities shall be recognized when they are incurred regardless of whether they are covered by available budgetary resources.*

In the FY 2009 audit report, we recommended that MCC ensure that all countries, types of funding, and programs be considered when recording accruals. We further recommended that MCC communicate procedures to MCAs to require 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. No such communication was made to the MCAs.

Upon notification of such material omissions and auditor adjustments, MCC made additional inquiries to obtain better data and adjusted the FY 2010 statements for an additional $95 million. Based on these adjustments, it was noted that amounts were not accrued for FY 2009 in the same fashion. As a result, FY 2009 expenses were understated, and FY 2010 expenses overstated for work performed in FY 2009 but not reported or accrued in the FY 2009 statements. For this reason, we qualified our opinions on both fiscal years.

**Recommendation.** We recommend that MCC Division of Finance revise and strengthen its process for determining accruals needed at yearend by implementing the following:

- Establish a comprehensive methodology and/or standard process for obtaining yearend accruals which covers all MCAs and funds. Ensure that accruals include invoiced and rendered services which have not been recorded in the yearend trial balance.

- Establish consistent communication with NBC and the MCAs to ensure a clear understanding of the process and methodology developed.

- Perform quality control procedures over amounts obtained and recorded to ensure that amounts posted are properly reviewed for reasonableness, accuracy, and completeness.

- Ensure that current and prior year financial statements are fairly stated as it relates to accruals recorded.

### 3. MONITORING CONTROLS OVER MCA ACTIVITIES

Most activities and expenses occurred in the Compact and Threshold programs. As such, controls in the mission countries must be adequately designed and operating effectively. Also, MCC must be actively monitoring controls to gain sufficient assurance over activities taking place and reliance of financial information being reported.

While we identified improvements related to complete and timely submission of documentation from the missions and accurate reporting of re-disbursements on quarterly financial reports, weaknesses continued through untimely performance and lack of monitoring of MCA audits. This was identified in the prior-year report and is discussed under Item A, below.

We also identified other weaknesses related to mission activities regarding:

- Improper and Untimely Quarterly Reporting (Item B, below)
- Inadequate Oversight of 609(g)-fund Transactions (Item C, below)
- Inadequate Processing of Closed Programs (Item D, below)

The combination of these weaknesses increases MCC's risk of inaccurate, incomplete, and untimely reporting of MCA activities. Each area is detailed below.

**A. Untimely Performance of MCA Audits**

This is a repeat finding from the prior year. Audits of controls, transactions, and balances of MCA entities were not completed, submitted to the Office of Inspector General (OIG), or issued in a timely manner. While we identified some improvements in the monitoring of these audits by management, the results of untimely completion remain.

As a major component of internal control over the MCAs, MCC required audits to be conducted on a semiannual basis for the six months ending December and June of each year. Audit results give MCC some assurance over the effectiveness and accuracy of MCA controls and transactions, because supporting documentation for transactions reported are not reviewed or maintained by MCC or its service provider. Instead, MCC relied on approved advance, disbursement, and payment request documents submitted by MCA personnel.

We inquired of MCC management and the OIG as to the status of MCA audits. The status of audits for the 6 months ending December 31, 2009, is summarized below. Audit reports were due by March 31, 2010.

Of 18 MCAs that had entered into force and were due for audit:

- Three audit reports are past due.

- One audit report was rejected by the OIG due to concerns over audit procedures.

- The audit period for one MCA was extended and will be combined with the June 2010 audit.

- Five audit reports were submitted to the OIG and are currently under review. Only one of these reports was submitted timely, others were submitted in July and August.

- Eight audit reports were issued by the OIG (all were issued in June, August, and September 2010, after the March 31 due date). Only three of these reports were initially submitted to the OIG by the March 31 due date.

The status of audits for the 6 months ending June 30, 2010, in which audit reports were due by September 30, 2010, are summarized below.

Of 17 MCAs that had entered into force and were due for audit:

- Nine audit reports are past due.

- Five audits were extended and will be included in the December 2010 audit. Extensions relate to delayed start of current period audits, untimely procurements, and issues with auditors.

- Three audit reports were submitted to the OIG and are under review. Two were received by the September 30 due date, and one was received on October 1.

- No audits have been issued as final by the OIG as of September 30.

Outstanding audit reports for the period ending June 30, 2010, which cover two quarters of FY 2010 activity, will now be received well after the current fiscal period, and will not be useful in MCC's assessment or assurance of MCA's FY 2010 activities.

Audit reports 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. OIG comments, which can delay audit report issuance, have related 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 MCA auditors.

OIG's *Guidelines or Financial Audits Contracted by the Millennium Challenge Corporation's Accountable Entities* (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… are performed in a timely manner;…* (§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)…* (§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).

Lack of accurate and timely audit processing (including procurement, execution, and submission of reports) increases MCC's risk of not knowing, in a timely manner, the effectiveness and accuracy of MCA activities in regards to costs incurred, transactions recorded, and existence of underlying support.

**Recommendation.** We recommend that the MCC Department of Compact Operations and Division of Finance:

- Continue to actively monitor the MCA audit process, from procurement and start of the audit through issuance of the audit report to ensure timely completion and sufficient time for OIG review and MCC consideration of any impact on its financial reporting.

- Continue active communication with MCAs, audit firms, and the OIG to ensure all parties are adequately informed of the progress of all audits.

- Ensure that MCAs and respective auditor firms understand the importance of timely and complete audits and how they affect MCC's assessment and reliance of overall MCA controls.

**B. Improper and Untimely Quarterly Reporting**

MCAs did not submit QFRs and Disbursement Requests properly or in a timely manner. We reviewed QFRs for all funds from a sample of 5 of MCC's 18 active MCAs and noted the following:

- FY 2010 Quarterly Disbursement Requests and QFRs were not received for:
  - MCA-Benin's CIF (last reporting was FY 2006).
  - MCA-Namibia's 609(g) funds (last reporting was FY 2009).

- MCA-Burkina Faso did not submit Disbursement Requests in a timely manner for its 609(g), CIF, and Compact funds during FY 2010.

- MCA-Lesotho submitted its Compact fund Disbursement Requests without formal signatures of appropriate MCA personnel, including the Fiscal Agent who assists in its preparation. Instead, MCA personnel waited until all documents were vetted, revised and resubmitted, and approved by MCC before submitting a request to the MCA Board for formal approval, which is not the standard process.

- MCA-Lesotho's Resident Country Director did not formally or timely document his approval of quarterly submissions.

- MCA-Mongolia and MCA-Namibia submitted some FY 2010 quarterly reports with incorrect Compact or CIF numbers.

We also noted during our review of Compact and CIF funds for MCA-Burkina Faso, which are administered by United States Agency for International Development (USAID), that QFRs were not submitted to MCC in a timely manner for all of FY 2010. Upon notification by the auditors, the QFRs were requested, and liquidations against this advance were posted in the amount of $11.8 million.

MCC's Financial Management Policies and Procedures (FMPP) on Compact Management (as updated in A&F-2007-77.2 received during FY 2010 audit) states the following:

> *The Accountable Entity is required to submit a QFR at least every fiscal quarter even if no additional cash is to be requested. In addition, separate QFRs are due for 609(g) funds and for funds provided under other mechanisms (e.g. Compacts) when both are disbursed in the same period. QFRs are due to MCC twenty (20) calendar days prior to end of the quarter (§5.3).*
>
> *The Disbursement Request, which is completed by the Accountable Entity team and Fiscal Agent, details the requested budgeting authority to cover the projected disbursements made through CPS during the next quarter (§5.4).*

FMPP further details responsibilities of the Accountable Entity Designated Officials and Fiscal Agents to jointly prepare and submit QFRs and Disbursement Requests to Transaction Team Leadership (§6.5; 6.7).

MCAs did not submit final QFRs to report final disbursement amounts when fund use was completed. This precludes MCC from properly and timely deobligating any unneeded funds. Untimely receipt of QFRs and Disbursement Requests, including those not properly approved, increases the risk to MCC that current-year transactions and accruals are inaccurate or incomplete.

**Recommendation.** We recommend that MCC management and Department of Compact Operations:

- Ensure that all personnel responsible for QFRs adhere to requirements to submit accurately prepared and properly approved QFRs and Disbursement Requests in a timely manner.

- Ensure that funds are periodically reviewed to determine if MCAs should submit final QFRs to record deobligations for funds no longer needed.

**C. Inadequate Oversight of 609(g)-Fund Transactions**

MCC's original intent was to manage 609(g) funds provided for countries and ultimately have oversight of all transactions and underlying support until an MCA was established, and a Compact was issued and entered into force. Processes have evolved, and MCC has allowed some countries with only an established Millennium Challenge Unit (MCU), rather than an MCA, to manage their own 609(g) funds, referred to as "country managed."

This new process did not always include MCC involvement and/or review of underlying invoices for reported expenses for MCAs. Thus, MCC management did not review these transactions until they were included in the agency's annual financial statement audit, because MCA audits do not occur without an MCA in place.

We identified other matters during our review of policies and procedures over 609(g) funds:

- Controls over approvals of vendor invoices and related payments for country-managed funds were established, but were not adequately or formally documented or shared with relevant personnel.

- Countries with the ability to approve their own invoices did not clearly document those approvals and authorizations to pay.

- The Fiscal Accountability Director and Assistant Chief Financial Officer (CFO) did not document their approvals of PRF submitted by in-country persons for vendor payments via CPS.

- Names and signatures on PRFs submitted for two sampled items did not match MCC CPS Signature Cards on file for the country.

- Sampled CPS Signature Cards did not have effective dates or MCC signatures ensuring card validity before being sent to NBC.

In addition, during our review of balances as of March 31, 2010, we identified several countries with active compacts that had 609(g) balances for which disbursements had not been made for one or more fiscal years. MCC Compact personnel did not adequately review aged obligations for countries with 609(g) funds to determine if "an immediate need" still existed. At yearend, we noted disbursement activity for some funds, while others were deobligated.

FMPP, Section 210, *Policies and Procedures on Authorizing and Recording Commitments and* Obligations, states:

> *MCC ensures that obligated funds are de-obligated when an obligating or authorizing official determines that the funds are no longer needed. … At the end of each quarter, MCC's DCFO initiates and coordinates a 1311 Review of Open Obligations for…609(g) and audit funds to identify and de-obligate any excess or unneeded balances. … In addition to the quarterly review of open obligations led by the DCFO, authorizing and obligating officials are required to routinely monitor and review unexpended obligated balances for which they are responsible to ensure that balances are de-obligated when no longer needed* (§6.2, *Review and De-Obligation of Unliquidated Obligations;* §5.2 in draft FMPP of same name).

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

> *Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations.*

The MCC Fiscal Accountability Director for one country documented a cursory set of desk procedures for entities for which funds are country-managed. This procedures document was not, however, vetted through any formal process, and it was not a shared document, thereby preventing other Fiscal Accountability Directors from using the same procedures for the same or similar processes.

The failure to have a prescribed set of procedures for 609(g) administration creates the risk that each country will be managed by a different set of guidelines, and that sufficient controls may not be in place to ensure proper approval and request of vendor invoices and payments and accurate reporting of transactions to MCC.

**Recommendation.** We recommend that MCC Department of Compact Operations coordinate with appropriate management levels to implement a formal process for administering 609(g) funds in all countries not managed by either MCC or an MCA.

We further recommend that MCC Department of Compact Operations, in coordination with the Division of Finance:

- Monitor on at least a quarterly basis obligations and disbursements of all countries that received 609(g) funds and communicate with the MCAs to determine if immediate needs still exist to maintain excess 609(g) funds that have not been disbursed within a period of 9 months or more and deobligate 609(g) funds no longer considered an immediate need to the MCA/Partnering Country.

- Strengthen its CPS Signature Card process to include an MCC authorizing signature, effective and termination dates, and annual or other periodic review process for MCC, its financial service provider, and the MCAs to ensure that signature cards are kept on file for only active users of the CPS system.

### D. Inadequate Processing of Closed Programs

MCC did not have a comprehensive close-out process for its compacts and other programs, specifically those terminated or suspended. MCA-Madagascar was formally terminated August 31, 2009, after which MCC Fiscal Accountability worked with MCA Fiscal Agents to determine a timeline for the audit and for processing payments. During our review of this program that ended in August 2009, we noted the following during the "wind-up" period:

- The audit performed in-country did not encompass the entire compact activity period or any period involving wind-up activities. The last audit covered the period January 1 to September 30, 2009, whereas wind-up activities were not scheduled to end until December 3, 2009.

- The detailed cash management plan did not allow for administrative wind-up activities that might occur after the December 3, 2009, period, and it did it not mention the provision for payment to the auditor for the final audit period or final payments to the Fiscal and Procurement Agents.

- The detailed cash management plan did not provide for balances remaining on MCC's general ledger for outstanding advances and undelivered order balances.

- QFRs were not submitted for MCA-Madagascar since August 14, 2009.

- Budget authority was appropriately established and approved for the period ending December 3, 2009, although three PRFs were submitted to NBC for payment after this date.

MCC's *Guidelines for the Program Closure of Millennium Challenge Compacts*, effective September 8, 2009, do not provide for terminated or suspended programs, instead stating that specific guidelines can be applied to any of the closed programs. The final disbursement period should be extended to include an additional 60 days to ensure that valid invoices received after the Closure Period can be submitted and paid, and, if the spending authority is not sufficient to cover expenses after that period, then additional spending authority must be requested and approved (§5.7.3, Spending Authority for Final Disbursement Period, and §5.7.5, Cash Flow Management). When all disbursements have been made during the specified Closure Period, the final QFR should be submitted to report actual expenditures. Due to timing of the Closure Period and audit end dates, special arrangements should be made for final payment to the audit firm (§5.10.4, Final Financial Audit).

Finally, MCC's *Financial Management Policies and Procedures for Compact Management*, as well as its instructions for submitting QFRs, discusses requirements for submitting QFRs for each quarter that funds are maintained for a compact, whether activity has occurred or not, until a final QFR is submitted (A&F-2007-77.2, §5.3).

As a result of not having and/or adhering to comprehensive close-out procedures:

- Payments were processed after budgeted authority expired.

- MCC Division of Finance was unable to determine if expenses needed to be accrued or liquidations posted, because it did not have interim and final QFRs.

- MCC is at risk for funds being used for expenses that would not be considered allowable under a fully documented Compact Closure Plan.

**Recommendation.** We recommend that MCC management and Department of Compact Operations:

- Develop policies and procedures for Program Closure of Compacts that have been suspended or terminated to ensure that programs, activities, and assets are properly accounted for, and final disposition is reported to MCC.

- Ensure that Fiscal Accountability Directors, Fiscal Agents, as well as personnel in the Division of Finance and MCC's financial services provider are fully aware of any restrictions to process payments made during a program or compact close-out period.

## SIGNIFICANT DEFICIENCIES

### 4. Reconciling Fund Balance with Treasury

USAID administers the Threshold Program for MCC, and Phoenix is the accounting system of record. Many of USAID's cash balances at Treasury for individual appropriations are different from cash balances in the accounting system for those appropriations. During the review of internal controls, we noted that USAID was granted a waiver from Treasury to temporarily post transactions to the suspense account. USAID has not, however, complied with Treasury's requirement that transactions be taken out of the suspense account and accurately posted within 60 days. Balances in the USAID suspense account are significant and are not cleared and recorded to the correct appropriation in a timely fashion. USAID's suspense aging report includes amounts from prior fiscal years.

The Treasury Financial Manual (TFM), *Preparing FMS 224*, Paragraph 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.*

Paragraph 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.*

USAID cash balances recorded in Phoenix do not tie to balances reported by Treasury. These differences are caused by prior-year mistakes when USAID recorded outlays in a different appropriation than Treasury did and by timing differences. The existence of old transactions that have not been cleared from the suspense account is caused by a lack of monitoring in prior years and an ongoing difficulty with matching incoming and outgoing suspense transactions. Untimely reconciliation of balances in the suspense account presents a risk of potential misstatements to the Fund Balance with Treasury line item.

**Recommendation.** We recommend that the MCC Division of Finance continue to follow USAID's progress toward elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC's risk of potential misstatements.

## 5. Controls over Financial Reporting

This is a repeat finding from prior-year audits. MCC needs to continue to strengthen its quality control procedures over financial information presented to ensure accuracy and completeness. In addition, these quality control procedures should be adhered to ensure the "quality" of information over the "timeliness" of information. Although MCC has improved its review process, with documentation of its review by the Assistant CFO and the Deputy CFO, review procedures are still insufficient, and a process does not exist for documenting and correcting errors in a timely manner. As a result, adjustments are not being made promptly, and an audit trail does not exist to identify these issues.

We noted the following deficiencies in the preparation and review of quarterly and yearend financial statements:

- There was a $30 million overstatement in the second-quarter trial balance as the result of a posting error to the Appropriations Received account. MCC stated that is knew about this material misstatement, but submitted the resulting statements to OMB and its auditor without correction or notification.

- An on-top adjustment from the prior-year audit was omitted from budgetary accounts, resulting in understated recoveries of prior-year obligations. MCC failed to account for all prior-year adjustments to ensure proper balances in the current year when preparing its second-quarter statements.

- Although not material in nature, we identified differences in comparing proprietary expenses and budgetary expended authority in the second and third quarters, respectively.

- The manual nature of the Excel spreadsheet used to prepare the financial statements lends itself to human error and extensive posting and tracking of adjustments. In addition, one person is responsible for preparing the spreadsheet, and quality control procedures do not include a review and agreement of information in the trial balance to the notes.

- In an effort to meet due dates and submit timely statements and notes, MCC did not complete its established quality control process before submitting draft yearend statements and notes. This process involves reviewing notes and other financial information in the financial statement package for accuracy and consistency with financial statement and trial balance information. We identified mathematical errors, incorrect prior-year balances, and inconsistent information.

- MCC lacks sufficient communication with the MCAs to ensure that they understand the impact of their transactions on MCC's financial statements and provide information that is complete, accurate, and sufficient for MCC's accrual reporting.

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.

**Recommendation.** We recommend that the MCC Division of Finance:

- Continue to strengthen its quality control reviews over financial statements to ensure that information presented is accurate, complete, and complies with accounting standards and reporting guidance.

- Establish quality control procedures to document during the review process any discrepancies, errors, and other anomalies that have occurred to provide an audit trail of issues that may require on-top adjustments.

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

MCC's management comments to recommendations are in the appendix to this report. We did not audit MCC's response and, accordingly, we provide no opinion on it.

This report is intended solely for the information and use of USAID, MCC management, and 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

November 15, 2010
Alexandria, Virginia

## APPENDIX
## MANAGEMENT COMMENTS

MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

# Memorandum

Date: November 12, 2010

To: Alvin A. Brown
Assistant Inspector General
Millennium Challenge Corporation

From: Victoria B. Wassmer, Vice President
Millennium Challenge Corporation
Department of Administration and Finance

Subject: Management Response to Draft Independent Auditor's Report on MCC's Financial Statements for Fiscal Years Ended September 30, 2010 and 2009.

We have received the subject draft report and note that the independent auditors, Cotton & Company, LLP, have issued a narrow qualified opinion on our principal financial statements. The qualification and related material weakness, which also affected our FY 2009 opinion, primarily relates to the accuracy of accruals for work not paid or invoiced until the subsequent period.

We at the Millennium Challenge Corporation (MCC) take our fiduciary responsibilities very seriously. Our team has been moving aggressively to ensure accountability, effective stewardship and transparency regarding the resources entrusted to MCC. Our goal is to provide sound financial management, financial reporting and internal control systems that will help ensure successful implementation of programs for sustainable poverty reduction through economic growth. We initiated a variety of aggressive actions in FY 2010 to address internal controls and other issues.

Now, in addition, MCC management is currently organizing a Task Force to quickly and effectively address the material weaknesses raised in the FY 2010 audit. The joint Task Force of the Department of Administration and Finance (A&F) and the Department of Compact Operations (DCO) will be working with key stakeholders, including Millennium Challenge Account (MCA) country entities, to:

(1) Analyze and revise current processes, procedures, and reporting related to the financial management and oversight of our partner countries' activities for accuracy, consistency, and shared agreement on how and why we need to address issues arising in large part from the different cash and accrual methods used by MCAs and MCC, respectively, and

(2) Develop and provide training to implement detailed corrective action plans with milestone dates to implement Task Force recommendations.

Any questions may be addressed to Mr. Dennis Nolan, Deputy Chief Financial Officer, or to me.

MCC management also offers these responses to the five areas of audit recommendations made by the Assistant Inspector General, Millennium Challenge Corporation.

***1. Material Weakness: Reporting Advance Payments***

MCC concurs with the OIG recommendation to “modify the Payment Request Form (PRF) to specifically identify requests for advance payments to vendors.” In addition, A&F will work with the Office of the Inspector General (OIG) to modify the existing scope of semi-annual MCA audits to include audit procedures to verify the accuracy and completeness of amounts coded as advances on PRFs.

MCC also concurs with the OIG recommendation that MCC “provide training to Fiscal Agents and other in-country personnel to explain how to properly record each line of the PRF” and to ensure shared understanding of the necessity and importance.” Through the Task Force mentioned earlier, MCC will ensure the requirement for advance payments to vendors be clearly identified, appropriately recorded in the accounting system and supported by documentation as part of the training for both MCC and MCA staff as needed.

***2. Material Weakness: Compiling Accruals (Proper Reporting Period)***

MCC concurs with the OIG recommendation to “revise and strengthen its process for determining accruals needed at year-end by establishing a comprehensive methodology and/or standard process for obtaining, recording and reporting year-end accruals which cover all MCAs and funds and include invoiced and rendered services which have not been recorded in the year-end trial balance.” MCC has already implemented a new year-end procedure and will build in further changes and necessary steps to ensure that both quarterly and year-end accruals are complete.

MCC extended its FY 2010 cut-off to 12 days for invoices received but not paid in response to accrual related issues raised in the FY 2009 audit. Based on the accrual-related issues raised in the FY 2010 audit, MCC’s new procedure to develop quarterly and year-end accruals for financial statement reporting entailed working directly with the Fiscal Agents, Procurement Directors, and other staff at the MCAs to obtain quarterly and year-end accrual reporting for: (1) invoices received but not paid, (2) work completed but not billed, (3) retention payments, and (4) country-managed 609(g) agreements.

In addition, MCC will be recalculating our FY 2009 expense accrual using the methodology described above to correct any errors in the beginning balances on our FY 2010 financial statements. Finally, MCC will institute regular communication with MCA staff to ensure that accruals are comprehensive, and reflect all activities that are occurring in country as part of compact implementation.

MCC also concurs with the recommendation to "establish consistent communication with NBC and the MCAs and establish a process to ensure a clear understanding of process and methodology developed." Through the Task Force mentioned earlier, MCC will ensure that the methodology for obtaining, recording, and reporting accruals is part of the training for both MCC and MCA staff as needed.

MCC also concurs with the recommendation to "perform quality control procedures over amounts obtained and recorded to ensure that amounts posted are properly reviewed for reasonableness, accuracy, and completeness." A&F also will work with the OIG to modify the existing scope of semi-annual MCA audits to include audit procedures to verify the accuracy and completeness of the data provided by the MCAs to calculate accruals. In conjunction with the semi-annual audits, A&F will also institute a process to sample MCA invoices and other documentation to verify the completeness and accuracy of accruals.

***3. Material Weakness:* Monitoring Controls over Mission Activities**

MCC concurs with the recommendation to "implement a process for coordinating with MCAs, audit firms, and the OIG to ensure all parties are adequately informed of the progress of all audits, and that the audits are completed in accordance with the compact." MCC has developed a reporting system to track the status of all MCA audits. As noted by our auditors, there has been considerable progress on eliminating the backlog of past due audits. MCC will continue its monitoring of the MCA audit program, and will work closely with the OIG to implement additional remedial actions or changes designed to improve the audit program.

In FY 2010 MCC implemented certain measures to improve timeliness of the MCA audit program; however, their full effect has not been realized. OIG's increase in staffing on the MCA audit program will also assist in alleviating a backlog in the audit report approvals process. MCC's Compliance Officer in conjunction with the Fiscal Accountability Directors in DCO will conduct monthly audit status meetings with OIG to ensure that issues related to the completion of MCA audits are addressed timely.

MCC also concurs with the recommendation to "establish and implement a process to ensure that MCAs prepare and make available for audit the status of advances to contractors, retention balances and data necessary for MCC to properly report its accruals." A&F will work with the OIG to modify the existing scope of semi-annual MCA audits to include audit procedures to verify the accuracy and completeness of the data provided by the MCAs to calculate advances, retention payments, and accruals.

MCC also concurs with the recommendation to "establish and implement a process to ensure that all personnel responsible for QFRs understand how to submit accurately prepared and properly approved QFRs and Disbursement Requests in a timely manner." Through the Task Force mentioned earlier, MCC will review and revise existing processes to ensure that quarterly reporting requirements are met.

In addition, A&F has developed a QFR scorecard to track the status of all required QFRs for all funds. The scorecard will be distributed weekly to MCC senior management for follow-up actions on delinquent QFRs.

MCC also concurs with the recommendation to "establish and implement a process to ensure that funds are periodically reviewed to determine if MCAs should submit final QFRs to record deobligations for funds no longer needed." This recommendation has already been implemented. A&F performs a semi-annual review of all open obligations which includes all fund types. This process is outlined in the Financial Management Policies and Procedures for Authorizing and Recording Commitments and Obligations issued in September 2010.

MCC also concurs with the recommendation to "implement a formal process for administering 609(g) funds in all countries not managed by MCC or MCA."
MCC has developed operating procedures regarding the management of 609(g) funds when the Fiscal Agent has not been selected and mobilized. These procedures will be formalized and incorporated in MCC's Financial Management Policies and Procedures.

MCC also concurs with the recommendation to "monitor on quarterly basis the cumulative obligation and disbursements of all countries that have received 609(g) funds and communicate with the MCAs to determine if there is still an immediate need to maintain excess 609(g) funds that have not been disbursed." This recommendation has already been implemented. A&F performs a semi-annual review of all open obligations which includes all fund types. This process is outlined in the Financial Management Policies and Procedures for Authorizing and Recording Commitments and Obligations issued in September 2010.

MCC also concurs with the recommendation to "strengthen its Common Payment System (CPS) Signature Card process to include an MCC authorizing signature, effective and termination dates, and annual or other periodic review process for MCC, its financial service provider, and the MCAs to ensure that signature cards are kept on file for only active users of the CPS system." A&F, in coordination with DCO, will strengthen the CPS Signature Card process to include a MCC authorizing signature, effective and termination dates, and include at a minimum, a quarterly review of the CPS process and update the CPS manual to include the revised controls.

MCC also concurs with the recommendation to "develop policies and procedures for Program Closure of Compacts that have been suspended or terminated to ensure that programs, activities, and assets are properly accounted for, and final disposition is reported to MCC." A&F and the DCO will review the existing *"Guidelines for the Program Closure of MCC Compacts"* to ensure that it is inclusive of policies and procedures for suspended and/or terminated compacts.

MCC also concurs with the recommendation to "establish guidelines for Fiscal Accountability Directors, Fiscal Agents, as well as personnel in the Division of Finance and MCC's financial services providers to make them fully aware of any restrictions to process payments made during a program or compact close-out period." A&F and the DCO will review the existing *"Guidelines for the Program Closure of MCC Compacts"* to ensure that it is inclusive of policies and procedures related to budget authority and required authorizations for the expenditure of funds during and after the compact close-out period. The Guidelines will be communicated to all responsible parties.

***1. Significant Deficiency: Reporting Fund Balance with Treasury***

MCC concurs with the recommendation to “continue to follow USAID’s progress toward elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC’s risk of potential misstatements.” A&F will continue to inquire each quarter (in conjunction with USAIDs preparation and delivery of MCC Threshold trial balances) of USAID’s progress towards elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC’s risk of potential misstatements.

USAID Response: USAID has control over current transactions but was not able to eliminate the backlog of old differences. USAID expects that the improvements we made in our systems for controlling cash, especially for DHHS, and suspense will enable us to keep current transactions under control for 2011 and give us time to clear up a substantial portion of our old differences.

***2. Significant Deficiency: Controls Over Financial Reporting***

MCC concurs with the recommendation to “continue to strengthen its quality control reviews over financial statements to ensure that information presented is accurate, complete, and complies with accounting standards and reporting guidance.” MCC implemented a further refinement to its quality control reviews over financial reporting--the Division of Finance Budget Officer and staff now review the Trial Balances and the Statement of Budgetary Resources. This additional layer of review compliments the reviews being conducted by the Division of Finance management team.

MCC also concurs with the recommendation to “establish quality control procedures to document during the review process any discrepancies, errors, and other anomalies that have occurred to provide an audit trail of issues that may require on-top adjustments.” The errors noted in the audit report stemmed from a miscommunication regarding an FY 2009 Financial Statement Audit adjustment processed during the FY 2009 annual close process. The miscommunication resulted in the need for an “on-top “adjustment to the final financial statements. In order to alleviate scenarios like this in the future MCC will request auditors timely submit adjustments using the MCC Journal Voucher template. MCC will continue to improve its quality control procedures by developing and adding an additional Excel spreadsheet worksheet to its financial statements workbook to be used to document systematic issues that may require “on-top” adjustments be made.

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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, 2010 and 2009, 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 15, 2010. 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) audit guidance.

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 audit guidance. We caution that noncompliance may have occurred and may not have been detected by these tests, and that such testing may not be sufficient for other purposes.

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 audit guidance. 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.

This report is intended solely for the information and use of United States Agency for International Development (USAID), MCC management, and 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

November 15, 2010
Alexandria, Virginia

**Appendix A**

Following is the disposition of prior year (2009) findings, recommendations, and MCC Management's action.

**Finding:**

**1. Control over Mission Activities and Support – Repeat Material Weakness**

**Status:** Overall finding still exists in FY 2010, although some of the components were closed. Finding was a material weakness in FY 2009, and is again in FY 2010.

**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.

**Status:** Open.

**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 be readily available and promptly submitted for inspection when requested.

**Status:** Closed

**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.

**Status:** Closed.

## 2. Quality Control over Financial Reporting (Repeat Significant Deficiency)

**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.

**Status:** Open.

- 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.

**Status:** Closed.

## 3. Controls over Payroll Processes

### 3.1 Untimely and Incomplete Processing of Separated Employees

**Status:** Closed.

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

**Status:** Closed.

### 3.3 Lack of Support for Employee Selected Benefit Deductions

**Status:** Closed.

## 4. Proper Reporting Period (FY 2009 Significant Deficiently, FY 2010 Material Weakness)

**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.

**Status:** Open.

- 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.

**Status:** Open.

- 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.

**Status:** Open.

- 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.

**STATUS:** Closed.

### 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.

**Status:** Open.

- 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. *Open*

**Status:** Open.

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

Recommendation No. 1
MCC concurs with the recommendation to modify Payment Request Form (PFR) to identify requests for advance payments to vendors.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 2
MCC concurs with the recommendation to provide training to Fiscal Agents and other in-country personnel to explain how to properly record each line of the PRF.

Auditor Evaluation:
We conclude that management has adequately addressed this recommendation, and acknowledge that a management decision has been reached.

**Compiling Accruals (Proper Reporting Period)**

Recommendation No. 3 MCC concurs with this recommendation to establish a comprehensive methodology and/or standard process for obtaining, recording, and reporting yearend accruals which covers all MCAs and funds and include invoiced and rendered services which have not been recorded in the yearend trial balance.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 4
MCC concurs with this recommendation to establish consistent communication with NBC and the MCAs for understanding the process and methodology developed.

. Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 5
MCC agrees with the recommendation to perform quality control procedures over amounts obtained and recorded to ensure that amounts posted are properly reviewed for reasonableness, accuracy, and completeness.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

**Monitor Controls over MCAs Activities**

Recommendation No. 6
MCC agrees with the recommendation to implement a process for coordinating with MCAs, audit firms, and the OIG to ensure all parties are adequately informed of the progress of all audits, and that the audits are completed in accordance with the compact.

Auditor Evaluation:
We conclude that management has addressed this issue, and acknowledge that a management decision has been reached and final action taken.

Recommendation No. 7
MCC concurs with the recommendation to establish and implement a process to ensure that MCAs prepare and make available for audit the status of advances to contractors, retention balances and data necessary for MCC to properly report its accruals.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 8
MCC concurs with the recommendation to establish and implement a process to ensure that all personnel responsible for QFRs understand how to submit accurately prepared and properly approved QFRs and Disbursement Requests in a timely manner.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 9
MCC agrees with the recommendation to establish and implement a process to ensure that funds are periodically reviewed to determine if MCAs should submit final QFRs to record deobligations for funds no longer needed.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 10
MCC concurs with the recommendation to implement a formal process for administering 609(g) funds in all countries not managed by either MCC or an MCA.

Auditor Evaluation:
MCC has developed operating procedures regarding the management of 609(g) funds when the Fiscal Agent has not been selected and mobilized. MCC will formalized and incorporate in MCC's Financial Management Policies and Procedures. We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 11
MCC concurs with this recommendation. A&F currently performs a semi-annual review of all open obligations on a quarterly basis which includes all fund types. This process is outlined in the Financial Management Policies and Procedures for Authorizing and Recording Commitments and Obligations issued in September 2010.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 12
MCC agrees with the recommendation to strengthen its CPS Signature Card process. A&F, in coordination with DCO, will strengthen the CPS Signature Card process.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 13
MCC agrees to develop policies and procedures for Program Closure of Compacts that have been suspended or terminated to ensure that programs, activities, and assets are properly accounted for, and final disposition is reported to MCC.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 14
MCC concurs with this recommendation to establish guidelines for Fiscal Accountability Directors, Fiscal Agents, as well as personnel in the Division of Finance and MCC's financial services provider to make them fully aware of any

restrictions to process payments made during a program or compact close-out period.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

**Significant Deficiencies**

Recommendation No. 15
MCC concurs with the recommendation to continue to follow USAID's progress toward elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC's risk of potential misstatements.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 16
MCC concurs with the recommendation to continue to strengthen its quality reviews over financial statements to ensure that information presented is accurate, complete, and complies with accounting standards and reporting guidance.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

Recommendation No. 17 MCC also concurs with the recommendation to establish quality control procedures to document during the review process any discrepancies, errors, and other anomalies that have occurred to provide an audit trail of issues that may require on-top adjustments.

Auditor Evaluation:
We conclude that management has adequately addressed this issue, and acknowledge that a management decision has been reached.

## FINANCIAL SECTION

In accordance with the OMB Circular A-136, Financial Reporting Requirements, MCC is presenting its financial statements in the appropriate form and content for Fiscal Year 2010. The tables below outline the following financial statements:

- Balance Sheets
- Statements of Budgetary Resources
- Statements of Net Cost
- Statements of Changes in Net Position
- Audit the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2010 and 2009
- Notes to Financial Statements

## BALANCE SHEETS

| | FY 2010 | RESTATED FY 2009 |
|---|---|---|
| **Assets** | | |
| **Intra-Governmental** | | |
| Fund Balance with Treasury *(Note 2)* | **$6,554,088,712** | **$6,655,511,983** |
| Advances – Federal *(Note 5)* | 8,778,900 | 6,474,444 |
| **Total Intra-Governmental** | 6,562,867,612 | **6,661,986,427** |
| Accounts Receivable *(Note 3)* | 49,408 | 90,363 |
| General Property, Plant, and Equipment *(Note 4)* | 5,857,213 | 6,953,153 |
| Advances – Public *(Note 5)* | 182,343,189 | 103,874,266 |
| **Total Assets** | **$6,751,117,423** | **$6,772,904,210** |
| | | |
| **Liabilities** | | |
| **Intra-Governmental** | | |
| Accounts Payable – Federal *(Note 1F)* | $5,055,266 | $229,546 |
| Contributions and Payroll Taxes Payable | 476,667 | 467,304 |
| **Total Intra-Governmental** | **5,531,933** | **696,850** |
| Federal Employee and Veteran Benefits Payable | 12,444 | 35,751 |
| Accounts Payable – Public *(Note 1F)* | 208,104,353 | 65,665,061 |
| Accrued Funded Payroll Liabilities | 9,279,041 | 7,196,040 |
| **Total Liabilities** | **$222,927,770** | **$73,593,702** |
| | | |
| **Net Position** | | |
| Unexpended Appropriations – Other Funds | $6,522,071,077 | $6,694,361,386 |
| Cumulative Results of Operations – Other Funds | 6,118,576 | 4,949,121 |
| **Total Net Position** | **$6,528,189,653** | **$6,699,310,507** |
| | | |
| **Total Liabilities and Net Position** | **$6,751,117,423** | **$6,772,904,210** |

The notes are an integral part of these financial statements.

## STATEMENTS OF BUDGETARY RESOURCES

| | FY 2010 | RESTATED FY 2009 |
|---|---|---|
| **Budgetary Resources** | | |
| Unobligated Balance – Beginning of Period | $787,102,593 | $962,304,024 |
| Recoveries of Prior Years Obligations | 4,045,794 | 1,029,114 |
| **Budget Authority:** | | |
| Appropriations *(Note 1C)* | 1,105,000,000 | 875,000,000 |
| Non expenditure Transfers, Net, Anticipated and Actual | (2,377,922) | (679,000) |
| Permanently Not Available | (50,000,000) | 0 |
| **Total Budgetary Resources** | **$1,843,770,465** | **$1,837,654,138** |
| | | |
| **Status of Budgetary Resources** | | |
| **Obligations Incurred** | | |
| Direct | $899,566,345 | $1,050,551,545 |
| Unobligated Balance Available | 451,137,424 | 56,176,028 |
| Unobligated Balance Not Available | 493,066,696 | 730,926,565 |
| **Total Status of Budgetary Resources** | **$1,843,770,465** | **$1,837,654,138** |
| | | |
| **Change in Obligated Balance** | | |
| **Obligated Balance, Net – as of October 1, 2009** | | |
| Unpaid Obligations, Brought Forward, October 1 | $5,868,196,304 | $5,583,344,174 |
| Obligations Incurred | 899,566,345 | 1,050,551,545 |
| Gross Outlays | (1,154,208,950) | (764,670,301) |
| Recoveries of Prior Year Unpaid Obligations, Actual | (4,045,794) | (1,029,114) |
| **Obligated Balance, Net – End of Period** | | |
| Unpaid obligations | $5,609,507,905 | $5,868,196,304 |
| **Net Outlays** | | |
| Gross Outlays | $1,154,208,950 | $764,670,301 |

The notes are an integral part of these financial statements.

## Statements of Net Costs

| Program | FY 2010 | RESTATED FY 2009 |
|---|---|---|
| **Program Costs *(Note 7)*** | | |
| **Compact** | | |
| Gross Costs | $1,020,176,345 | $490,084,277 |
| Less: Earned Revenue | 0 | 0 |
| Net Program Costs | 1,020,176,345 | 490,084,277 |
| **609 (g) Programs** | | |
| Gross Costs | 19,551,450 | 15,693,976 |
| Less: Earned Revenue | 0 | 0 |
| Net Program Costs | 19,551,450 | 15,693,976 |
| **Threshold Programs** | | |
| Gross Costs | 58,985,525 | 120,372,199 |
| Less: Earned Revenue | 0 | 0 |
| Net Program Costs | 58,985,525 | 120,372,199 |
| **Due Diligence Programs** | | |
| Gross Costs | 28,555,929 | 28,922,102 |
| Less: Earned Revenue | 0 | 0 |
| Net Program Costs | 28,555,929 | 28,922,102 |
| **Audit** | | |
| Gross Costs | 3,517,852 | 3,792,544 |
| Less: Earned Revenue | 0 | 0 |
| Net Program Costs | 3,517,852 | 3,792,544 |
| **Administrative** | | |
| Gross Costs | 95,580,731 | 91,746,536 |
| Less: Earned Revenue | 0 | 0 |
| Net Program Costs | 95,580,731 | 91,746,536 |
| **Program Costs – Net of All Programs** | **$1,226,367,832** | **$750,611,635** |
| **Net Costs of Operations** | **$1,226,367,832** | **$750,611,635** |

The notes are an integral part of these financial statements.

## STATEMENTS OF CHANGES IN NET POSITION

| | FY 2010 | RESTATED FY 2009 |
|---|---|---|
| **Cumulative Results of Operations** | | |
| Beginning Balances | $4,949,121 | $6,839,070 |
| Adjustments | | |
| Beginning Balance, as Adjusted | 4,949,121 | 6,839,070 |
| **Budgetary Financing Sources** | | |
| Appropriations Used | $1,224,912,387 | $746,726,904 |
| **Other Financing Sources** | | |
| Donations and Forfeitures of Property *(Note 1P)* | $269,513 | $205,267 |
| Imputed Financing | 2,355,386 | 1,789,515 |
| Total Financing Sources | 1,277,537,287 | 748,721,686 |
| Net Cost of Operations | (1,226,367,832) | (750,611,635) |
| Net Change | 1,169,455 | (1,889,949) |
| **Cumulative Results of Operations** | **$6,118,576** | **$4,949,121** |
| | | |
| **Unexpended Appropriations** | | |
| Beginning Balance | $6,694,361,386 | $6,548,610,190 |
| Adjustments | | 0 |
| Correction of errors | | 18,157,101 |
| Beginning Balance, as Adjusted | $6,694,361,386 | $6,566,767,291 |
| **Budgetary Financing Sources** | | |
| Appropriations Received | $1,105,000,000 | $875,000,000 |
| Appropriations Transferred In/Out | (2,377,922) | (679,000) |
| Other adjustments | (50,000,000) | 0 |
| Appropriations Used | (1,124,912,387) | (746,726,904) |
| Total Budgetary Financing Sources | (172,290,309) | 127,594,096 |
| Total Unexpended Appropriations | $6,522,071,077 | $6,694,361,386 |
| **Net Position** | **$6,528,189,653** | **$6,699,310,507** |

The notes are an integral part of these financial statements.

## NOTES TO FINANCIAL STATEMENTS (AS OF SEPTEMBER 30, 2010)

### 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 $1.105 billion and $875 million in Fiscal Year 2010 and Fiscal Year 2009, 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. Accounts payable reported at the end of Fiscal Year 2010 were $208 million (non-Federal) and $5.1 million (Federal) and at the end of Fiscal Year 2009 were $65.7 million (non-Federal) and $230 thousand (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 Fiscal Year 2010 and Fiscal Year 2009.

### 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 sick 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.

### J. Financing Sources

Per note 1C, 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 Fiscal Year 2010, MCC made retirement contributions of $104 thousand to CSRS, $2.8 million to FERS, and $1.1 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 $377 thousand and $213 thousand in interest remittances as of September 30, 2010 and 2009, respectively.

### 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 Fiscal Year 2010 was $270 thousand and Fiscal Year 2009 was $205 thousand.

### 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 Fiscal Year 2010 and Fiscal Year 2009, MCC transferred budgetary authority of $25 million and $33 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 Fiscal Year 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, 2010 and 2009 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, 2010 (in thousands) | RESTATED September 30, 2009 (in thousands) |
|---|---|---|
| **Fund Balances** | | |
| General Funds | $6,554,089 | $6,655,512 |
| **Total** | **$6,554,089** | **$6,655,512** |

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

| | September 30, 2010 (in thousands) | RESTATED September 30, 2009 (in thousands) |
|---|---|---|
| **Status of Fund Balance with Treasury** | | |
| Unobligated Balance | | |
| Available | $451,137 | $56,176 |
| Unavailable | 493,067 | 730,927 |
| Obligated Balance | $5,609,508 | $5,868,196 |
| Non-Budgetary FBWT | 377 | 213 |
| **Total** | **$6,554,089** | **$6,655,512** |

## 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 Fiscal Year 2010 and Fiscal Year 2009 were approximately $49 thousand and $90 thousand, 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 Fiscal Years 2010 and 2009 was $10.9 million. Accumulated amortization was approximately $5.2 million and $4.0 million, respectively. The current book value is $5.7 million and $7.0 million for the periods ending September 30, 2010 and 2009, 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. For Fiscal Year 2010, equipment was valued at approximately $139 thousand. Accumulated depreciation was approximately $20 thousand for Fiscal Year 2010. MCC did not have any equipment assets for Fiscal Year 2009.

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. MCC reported $191.1 million ($8.8 million, Federal and $182.3 million, non Federal) and $110.4 million ($6.5 million, Federal and $103.9 million, non-Federal) in advances as of September 30, 2010 and 2009, 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 June 28, 2015) and for eighteen (18) office copier machines (through January 31, 2012) utilized in both buildings. The future lease payments due are depicted in **Exhibit 15** below.

**Exhibit 15: Operating Leases**

| Future Lease Payments Due (in dollars) | | | |
|---|---|---|---|
| **Fiscal Year** | **Bowen** | **City Center** | **Total** |
| 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** | **$28,632,541** | **$9,817,586** | **$38,450,127** |
| **Future Lease Payments Due (in dollars)** | | | |
| **Fiscal Year** | **MCC Vehicle** | **MCC Copiers** | **Total** |
| FY 2011 | 10,980 | 55,821 | 66,801 |
| FY 2012 | 10,980 | 55,821 | 66,801 |
| FY 2013 | 10,980 | | 10,980 |
| FY 2014 | 10,980 | | 10,980 |
| FY 2015 | 8,235 | | 8,235 |
| **Total Future Lease Payments** | **$52,155** | **$111,642** | **$163,797** |

## 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 2010 Total (in thousands) | RESTATED FY 2009 Total (in thousands) |
|---|---|---|---|---|---|---|---|---|
| Intra-Governmental | 35 | 5 | 16,281 | 5,151 | 3,246 | 17,510 | 42,228 | 27,537 |
| Public | 1,017,189 | 19,547 | 43,407 | 23,467 | 272 | 80,258 | 1,184,140 | 723,075 |
| **Total - Program** | **1,017,224** | **19,552** | **59,688** | **28,618** | **3,518** | **97,768** | **1,226,368** | **$750,612** |

## NOTE 8—UNDELIVERED ORDERS AT THE END OF THE PERIOD

**Exhibit 17** presents Undelivered Orders, paid and unpaid, as of September 30, 2010 and 2009.

**Exhibit 17: Undelivered Orders**

| Undelivered Orders | 2010 | RESTATED 2009 |
|---|---|---|
| Administrative | $28,539,653 | $27,268,537 |
| Audit | 1,031,296 | 1,131,689 |
| 609(g) | 37,167,213 | 42,422,624 |
| Due Diligence | 65,060,507 | 60,123,947 |
| Program | 5,334,343,971 | 5,625,698,055 |
| Threshold | 111,935,476 | 148,518,787 |
| **Total** | **$5,578,078,116** | **$5,905,163,639** |

## 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 column for Fiscal Year 2009 and the Fiscal Year 2009 actual data reported in the Fiscal Year 2011 budget submission. Fiscal year 2010 actual data will be published within the 2012 Budget of the United States to be published in February 2011. No material differences were noted.

### NOTE 10—RESTATEMENTS

During Fiscal Years 2008 and 2009, MCA's erroneously reported vendor disbursements as expenses that should have been reported as advances for goods and services. MCA's also did not report to MCC any retention payments being withheld for services rendered during Fiscal Year 2009. Those amounts should have been accrued during Fiscal Year 2009 to capture those expenses when incurred. This restatement is being presented in the Fiscal Year 2009 column of these comparative financial statements. The Balance Sheet, Statement of Net Cost and Statement of Changes in Net Position are all affected by this restatement. The original reported amount, effect of the restatement and the restated amount are all summarized in **Exhibit 18** below.

MCC has developed a revised accrual methodology to communicate directly with each country to determine a more accurate estimate of the value of goods and services received; both invoiced and unbilled. MCC believes that direct communication with each MCA will allow for the proper treatment of expense accruals within the proper reporting period.

MCC has analyzed the issue surrounding the proper reporting of advances to vendors within country to perform services but reported to MCC as expenses. MCC is revising its Payment Request Form to ensure MCA's are accurately designating funds being disbursed to a vendor so that an advance or expense disbursed is recorded in the MCC financial system accurately. MCC will also be performing a reconciliation of those advances erroneously reported as an expense within each country to ensure the financial records within the MCC financial system is consistent with financial records within each country.

**Exhibit 18: Restatement of Fiscal Year 2009 Financial Statement Material Amounts**

| | 2009 Reported | Effect of Restatement | 2009 Restated |
|---|---|---|---|
| **Balance Sheet** | | | |
| Advances to Others | $32,422,386 | $71,451,880 | $103,874,266 |
| Total Assets | $6,701,452,329 | $71,451,880 | $6,772,904,210 |
| Accounts Payable | $56,026,101 | $9,638,960 | $65,665,061 |
| Total Liabilities | $63,954,742 | $9,638,960 | $73,593,702 |
| Unexpended Appropriations – other funds | $6,632,548,466 | $61,812,920 | $6,694,361,386 |
| Total Net Position | $6,637,497,587 | $61,812,920 | $6,699,310,507 |
| **Statement of Net Costs** | | | |
| Compact – Gross Costs | $533,740,058 | ($43,655,781) | $490,084,277 |
| Net Cost of Operations | $794,267,415 | ($43,655,781) | $750,611,635 |

| Statement of Changes in Net Position | | | |
|---|---|---|---|
| Budgetary Financing Sources – Appropriations Used | $790,382,685 | ($43,655,781) | $746,726,904 |
| Total Financing Sources | $792,377,466 | ($43,655,781) | $748,721,686 |
| Net Cost of Operations | ($794,267,415) | ($43,655,781) | ($750,611,635) |
| Corrections of Errors | (39) | $18,157,140 | $18,157,101 |
| Unexpended Appropriations – Beginning Balance, as adjusted | $6,548,610,151 | $18,157,140 | $6,566,767,290 |
| Budgetary Financing Sources – Appropriations Used | ($790,382,685) | $43,655,781 | ($746,726,904) |
| Total Budgetary Financing Resources | $83,938,315 | $43,655,781 | $127,594,096 |
| Total Unexpended Appropriations | $6,632,548,466 | $61,812,920 | $6,694,361,386 |
| Net Position | $6,637,497,587 | $61,812,920 | $6,699,310,507 |

## NOTE 11—RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

**Exhibit 19** 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 19: Reconciliation of Net Cost of Operations to Budget**

| Resources Used to Finance Activities | | Program Costs | |
|---|---|---|---|
| **Budgetary Resources Obligated** | | | |
| Obligations Incurred | $899,566,345 | **Gross Costs** | $1,226,367,832 |
| Recoveries of prior year unpaid obligations | (4,045,794) | | |
| Other financing resources | 2,624,899 | | |
| Total resources used to finance activities | 898,145,451 | | |
| Total resources used to finance items not part of the net cost of operations | 326,986,011 | **Less: Earned Revenue** | - |
| Total components of net cost of operations that will not require or generate resources | 1,236,370 | | |
| **Net Cost of Operations** | **$1,226,367,832** | **Net Cost of Operations** | **$1,226,367,832** |