



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

Audit of MCC's Fiscal Years 2019 and 2018 Financial Statements

AUDIT REPORT 0-MCC-20-004-C
NOVEMBER 18, 2019

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MEMORANDUM

DATE: November 18, 2019

TO: Millennium Challenge Corporation, Vice President, Department of Administration and Finance, Chief Financial Officer, Ken Jackson

FROM: Deputy Assistant Inspector General for Audit, Alvin Brown /s/

SUBJECT: Audit of MCC's Fiscal Years 2019 and 2018 Financial Statements (0-MCC-20-004-C)

Enclosed is the final audit report on Millennium Challenge Corporation's (MCC) financial statements as of September 30, 2019, and 2018. The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of CliftonLarsonAllen LLP (CLA) to conduct the audit. The contract required the audit firm to perform the audit in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin No. 19-03, "Audit Requirements for Federal Financial Statements."

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

The audit objectives were to: (1) express an opinion on whether the financial statements as of September 30, 2019, and 2018, were presented fairly, in all material respects; (2) evaluate MCC's internal controls; and (3) determine whether MCC complied with applicable laws and regulations. The purpose was not to provide an opinion on the effectiveness of the entity's internal control or compliance with provisions of applicable laws, regulations, contracts, and grant agreements.

To answer the audit objectives, the audit firm reviewed MCC's financial statements, including the balance sheets as of September 30, 2019, and 2018, and the related statements of net cost, changes in net position, the combined statements of budgetary resources for the years then

ended, and the related notes to the financial statements. The net operating costs for this period were \$545,516,000.

The audit firm concluded that MCC's financial statements for the fiscal years ending September 30, 2019, and 2018, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles. The audit firm also found no instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements.

The auditors reported two significant deficiencies in internal controls related to:

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

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

Recommendation 1. Update the "Grant Accrual Financial Management Division Desktop Procedures" to document and determine what MCC should do with validated costs identified that were not part of the accrued costs, and what was the root cause of the initial omission by MCA. Based on that outcome, MCC should revise MCA guidance as appropriate or provide additional training to prevent recurrence.

Recommendation 2. Update the "Grant Accrual Financial Management Division Desktop Procedures" to require MCC to review the adequacy of the MCAs' procedure manual that addresses the MCA internal process with its project directors and engineers for capturing work completed but not yet billed or paid. MCC should provide recommendations for improvement where warranted.

Recommendation 3. Update the "Grant Accrual Financial Management Division Desktop Procedures" to address and document what additional steps should be taken to ensure the reliability of the grant accrual estimate and the validation process when the compact is entering into its final year and or closure period (i.e., 120 days after the compact end date).

Recommendation 4. Develop, document, and implement an internal procedure that requires the Department of Compact Operations to disclose unique financial aspects of the compact, or additional financial agreements impacting the compact, to the Financial Management Division for review to determine if the MCA needs additional guidance to properly accrue for those costs.

Recommendation 5. Update the "Retentions Data Call: Millennium Challenge Account Guidance" to provide additional requirements for MCAs to reconcile retention balances reported in the quarterly data calls with the relevant balances recorded in the MCAs' financial system, investigate any variances noted, and submit this reconciliation with the quarterly data call to MCC for review.

Recommendation 6. Coordinate with the Vice President of Department of Compact Operations the updating of the "Fiscal Accountability Plans" to require MCAs to develop an internal process with project directors and engineers on how to capture work completed but not yet billed or paid, and document in a desktop procedure manual.

Recommendation 7. Coordinate with the Vice President of Department of Compact Operations the updating of the “Fiscal Accountability Plans” to require MCAs to ensure that the Fiscal Agent is integrated within the grant accrual process to verify when grant accruals have been paid and should no longer be reported as an accrual in the data call.

Recommendation 8. Provide MCAs with additional training concerning the reporting of advance liquidations in the grant accrual process for in-house invoices and works completed but not invoiced as of quarter end.

Recommendation 9. Develop, implement, and document procedures for how MCC will assist the MCAs to enable them to meet the compact/threshold audit requirements.

In finalizing the report, the audit firm evaluated MCC’s responses to the recommendations. After reviewing that evaluation, we consider all recommendations open and unresolved. We ask that you provide written notification of actions planned or taken to reach management decisions on recommendations 1 through 9.

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

MILLENNIUM CHALLENGE CORPORATION

Independent Auditors' Report
of Millennium Challenge Corporation's Financial Statements
for the Periods Ending September 30, 2019 and 2018

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To the Inspector General
United States Agency for International Development

To the Board of Directors
Millennium Challenge Corporation

INDEPENDENT AUDITORS' REPORT

In our audits of the fiscal years 2019 and 2018 financial statements of the Millennium Challenge Corporation (MCC), we found

- MCC's financial statements as of and for the fiscal years ended September 30, 2019, and 2018, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- No material weaknesses, but two significant deficiencies in internal control over financial reporting for fiscal year 2019 based on the limited procedures we performed; and
- No reportable noncompliance for fiscal year 2019 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on the financial statements, which includes required supplementary information (RSI) such as Management's Discussion and Analysis (MD&A) and other information included with the financial statements; (2) our report on internal control over financial reporting; (3) our report on compliance with laws, regulations, contracts, and grant agreements; and (4) management's response.

Report on the Financial Statements

We have audited MCC's financial statements. MCC's financial statements comprise the balance sheets as of September 30, 2019, and 2018; the related statements of net cost, changes in net position, and combined statements of budgetary resources for the fiscal years then ended; and the related notes to the financial statements (financial statements).

We conducted our audit in accordance with auditing standards generally accepted in the U.S.; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 19-03). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Management's Responsibility for the Financial Statements

MCC management is responsible for (1) the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America (U.S.); (2) preparing, measuring, and presenting the RSI in accordance with accounting principles generally accepted in the U.S.; (3) preparing and presenting other information included in documents containing the audited financial statements and auditors' report, and ensuring the consistency of that information with the audited financial statements and the RSI; and (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. Relevant standards referred to above require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. We are also responsible for applying certain limited procedures to RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the auditors' assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to MCC's preparation and fair presentation of the

financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MCC's internal control. Accordingly, we express no such opinion. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Opinion on the Financial Statements

In our opinion, MCC's financial statements referred to above present fairly, in all material respects, MCC's financial position as of September 30, 2019, and 2018, and its net costs, changes in net position, and budgetary resources for the fiscal years then ended, in accordance with accounting principles generally accepted in the U.S.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the U.S. issued the Federal Accounting Standards Advisory Board (FASAB) require that the information in MCC's RSI section be presented to supplement the financial statements. Such information, although not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with auditing standards generally accepted in the U.S., which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to the auditors' inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on this information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

MCC's other information contains a wide range of information, some of which is not directly related to the financial statements. This information as listed in the table of contents of MCC's Agency Financial Report is presented for purposes of additional analysis and is not a required part of the financial statements and the RSI. In addition, MCC management has included references to information on websites or other data outside of MCC's Agency Financial Report. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the

purpose of forming an opinion on MCC's financial statements as a whole. We did not audit and do not express an opinion or provide any assurance on all other information.

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

Report on Internal Control over Financial Reporting

In connection with our audit of the MCC's financial statements, we considered MCC's internal control over financial reporting (internal control), consistent with our auditors' responsibility discussed below. We performed our procedures related to MCC's internal control over financial reporting in accordance with auditing standards generally accepted in the U.S.

Management's Responsibility for Internal Control over Financial Reporting

MCC management is responsible for (1) maintaining effective internal control over financial reporting, including the design, implementation, maintenance, and evaluation of the effectiveness of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error, and (2) providing a statement of assurance on the overall effectiveness of internal control over financial reporting.

Auditors' Responsibility

In planning and performing our audit of MCC's financial statements as of and for the year ended September 30, 2019, in accordance with auditing standards generally accepted in the U.S., we considered MCC's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MCC's internal control over financial reporting. Accordingly, we do not express an opinion on MCC's internal control over financial reporting. We are required to report all deficiencies that are considered to be significant deficiencies or material weaknesses. We did not consider all internal controls relevant to operating objectives, such as those controls relevant to preparing performance information, statistical reports, and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. We caution that our internal control testing may not be sufficient for other purposes. We also caution that projecting our audit results to future periods is subject to risk that controls may become inadequate because of changes in conditions.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with accounting principles generally accepted in the U.S., and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error.

Results of Our Consideration of Internal Control over Financial Reporting

Our consideration of internal control was for the limited purpose described in section above, and was not designed to identify all deficiencies in internal control that might be material weaknesses and significant deficiencies or to express an opinion on the effectiveness of MCC's internal control over financial reporting. Given these limitations, material weaknesses or significant deficiencies may exist that have not been identified.

During our fiscal year 2019 audit, we identified two deficiencies in MCC's internal control over financial reporting that we considered as significant deficiencies. They are summarized below and detailed in Exhibit I.

Although the significant deficiency in internal control did not affect our opinion of MCC's fiscal year 2019 financial statements, misstatements may occur in unaudited financial information reported internally and externally by MCC because of these 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 a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of MCC's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Intended Purpose of the Report on Internal Control over Financial Reporting

The purpose of the Report on Internal Control over Financial Reporting is solely to describe the scope of our consideration of MCC's internal control over financial reporting and the results of our procedures, and not to provide an opinion on the effectiveness of MCC's internal control over financial reporting. The Report on Internal Control over Financial Reporting is an integral part of an audit performed in accordance with auditing standards generally accepted in the U.S. in considering internal control over financial reporting. Accordingly, the report on internal control over financial reporting is not suitable for any other purpose.

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

In connection with our audit of MCC's financial statements, we tested compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditors' responsibility. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes. We performed our tests of compliance in accordance with auditing standards generally accepted in the U.S. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported in accordance with *Government Auditing Standards* or OMB Bulletin 19-03.

Management's Responsibility for Compliance

MCC management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to MCC.

Auditors' Responsibilities

Our responsibility is to test compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements applicable to MCC that have a direct effect on the determination of material amounts and disclosures in MCC's financial statements, and perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts,

and grant agreements applicable to MCC. We also caution that projecting our audit results to future periods is subject to risk that the degree of compliance with controls may deteriorate.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for fiscal year 2019 that would be reportable under auditing standards generally accepted in the U.S. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to MCC. Accordingly, we do not express such an opinion.

Intended Purpose of the Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of the Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements is solely to describe the scope of our testing of compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with auditing standards generally accepted in the U.S. in considering compliance. Accordingly, the report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

Management's Response to Audit Findings

Management's response to the findings identified in our report is presented in Exhibit 2. MCC concurred with all recommendations and these are considered open-unresolved. We did not audit MCC's response and, accordingly, we express no opinion on it.

Status of Prior Year's Control Deficiencies

We have reviewed the status of MCC's corrective actions with respect to the findings included in the prior year's Independent Auditors' Report, dated November 8, 2018. The status of prior year findings is presented in Exhibit 3.

CliftonLarsonAllen LLP

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

Arlington, Virginia
November 15, 2019

EXHIBIT 1
Significant Deficiencies in Internal Controls

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

MCC's grant accrual liability is based on its Compact Accountable Entities' (also known as Millennium Challenge Accounts or MCAs) reporting grant accrual estimates to MCC via data calls. MCAs are also responsible for assisting MCC in validating the estimated liability. In FY 2019, MCC has performed additional oversight on the grant accrual estimates received from the MCAs on a monthly basis by: (1) identifying additional validation payments against MCAs' accrual estimates; (2) confirming that MCAs identified cost incurred in the prior quarter and associated payments were not re-accrued by the MCAs; and (3) verify that individual accrual items greater than \$100 thousand and were not paid by the MCAs will be re-accrued in the following quarter and if not, MCC will obtain the basis as to why the MCA made the initial accrual.

MCC reported approximately \$305 million in compact grant related expenses and an accrued grant liability of \$45 million comprising retentions payable and expenses incurred but not yet reported by MCAs as of September 30, 2019. The compact grant activities are the core of MCC's financial and program operations.

We audited the grant accruals and validation for reasonableness and compliance with MCC's *Expense Accruals Financial Management Division Procedure Manual* (Manual) that went into effect on February 15, 2019. MCC also issued accrual and validation guidance to the MCAs in December, 2018. MCC further revised its MCA validation guidance in June 2019 to provide additional clarification and guidance to the MCAs. In third quarter of FY 2019, MCC started requesting in their data call for the MCAs to provide source documentation used to determine accrual amount for any vendor over \$250,000. During FY 2019, MCC continued to refine its accrual methodology by collecting additional data from the MCAs to help validate their methodology. However, we identified the following data deficiencies during our testing that impacted the reasonableness of the quarterly grant accrual estimates. These issues increase the risk for the grant accrual estimate to be misstated and incorrectly reported in MCC's financial statements.

Issues with the Grant Accrual Estimates Versus Actual Validated Amounts – During our audit of the quarterly grant accrual, we noted significant errors in the grant accrual estimates that raise concerns about MCC's control process to ensure that its grant accrual methodology is valid and reliable. After accounting for valid accruals that were carried forward into the next quarter as well as accounting for MCC's and MCAs' cost validation conducted, we noted significant accrual variances in the fourth quarter of FY 2018 and first quarter of FY 2019 totaling \$3.8 million and \$12.6 million, respectively.

EXHIBIT 1
Significant Deficiencies in Internal Controls

Period	Accrual	Valid Accrual Carried Over	Adjusted Accrual	Validation (MCA & MCC)	Variance Amount Over or (under) the Accrual
Qtr. 4 FY18	\$47,823,473	\$2,210,000	\$ 45,613,473	\$49,452,481	\$3,839,008
Qtr. 1 FY19	\$43,588,443	\$2,974,826	\$ 40,613,617	\$53,204,237	\$12,590,620
Qtr. 2 FY19	\$27,622,069	\$5,069,978	\$ 22,552,091	\$24,056,555	\$1,504,464
Qtr. 3 FY19	\$28,004,223	\$4,544,919	\$ 23,459,304	\$21,768,084	\$(1,691,220)

A significant portion of the identified accrual variances were related to two compacts that were in the process of closing. MCC indicated that the government shutdown had an impact on its financial reporting. For one compact, MCC could not provide any support or explanation for the accrual variance of \$5.6 million in the fourth quarter of FY 2018 and \$3.6 million in first quarter of FY 2019. Another MCA did not accrue for government reimbursement payment of \$2.9 million in fourth quarter of FY 2018 and \$7.5 million in first quarter of FY 2019.

MCC's internal desktop procedures do not address what additional steps MCC should take to ensure the reliability of the grant accrual estimate and related validation process when the compact is entering into its final year of operation or in the closure period (120 days after the compact end date). In addition, MCC does not have any internal procedures that require the Department of Compact Operations to disclose to Financial Management Division unique financial aspects or additional financial agreements that may impact a compact (i.e. a government reimbursable agreement) and affect the accrual estimates.

MCC also identified additional costs incurred that the MCAs did not accrue as well as accrual errors reported by the MCAs. The total costs incurred that should have been accrued and the related accrual errors identified in our testing are shown below.

Period	Costs Identified That Should Have Been Accrued and Accrual Errors
Qtr. 4 FY18	\$2,594,490
Qtr. 1 FY19	\$12,399,725
Qtr. 2 FY19	\$2,370,099
Qtr. 3 FY19	\$4,031,257

EXHIBIT 1 Significant Deficiencies in Internal Controls

These costs represent a clear under estimation of the accrual costs for each quarter. In FY 2019, MCC has shown improvement in validating the accrual costs and identifying problems pertaining to the grant accrual estimation process. However, MCC needs to continue implementing corrective actions to address accrual errors and control deficiencies in the grant accrual estimation process in order to produce a reliable and reasonable grant accrual estimate.

Furthermore, MCC's internal desktop procedures do not address what MCC should do with the validated costs that should have been accrued but were not. Specifically, MCC procedures do not require a determination and documentation of the cause for why the MCA did not initially identify those costs in the grant accrual estimation process, so that MCC can revise its guidance to the MCAs to prevent such accrual errors in the future.

The MCC's grant accrual guidance to the MCAs indicates the MCAs should have a desktop procedure manual to address the accrual process with Project Directors and Engineers for capturing work completed but not yet billed or paid as of the end of the accrual reporting period. However, MCC's desktop procedures do not require MCC to review the adequacy of the MCAs' procedures.

There is a high risk of material misstatement in MCC's reporting of grant accrual liability and a potential for errors to occur if MCC does not clearly identify and address the root cause for the accrual variance errors and take appropriate corrective action in the form of additional guidance and training to MCAs to resolve them.

GAO Standards for Internal Control in the Federal Government, Section 3 – Evaluation of an Effective Internal Control System, Evaluation of Internal Control, Design and Implementation OV3.05 states that when evaluating implementation, management determines if the control exists and if the entity has placed the control into operation. A deficiency in implementation exists when a properly designed control is not implemented correctly in the internal control system. 12.03 states that management documents in policies for each unit its responsibility for an operational process's objectives and related risk, and control activity design, implementation, and operating effectiveness.

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

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

EXHIBIT 1
Significant Deficiencies in Internal Controls

Recommendation 1. Update the “Grant Accrual Financial Management Division Desktop Procedures” to:

- a. Document and determine what MCC should do with validated costs identified that were not part of the accrued costs and what was the root cause of the initial omission by MCA. Base on that outcome, MCC should revise MCA guidance as appropriate or provide additional training to prevent reoccurrence in the future.
- b. Require MCC to review the adequacy of the MCAs’ procedure manual that addresses the MCA internal process with its Project Directors and Engineers for capturing work completed but not yet billed or paid. MCC should provide recommendations for improvement where it is warranted.
- c. Address and document what additional steps should be taken to ensure that the reliability of the grant accrual estimate and the validation process when the compact is entering into its final year and or closure period (i.e., 120 days after the compact end date).

Recommendation 2. Develop, document and implement an internal procedure that requires the Department of Compact Operations to disclose unique financial aspects of the compact, or additional financial agreements impacting the compact, to Financial Management Division for review to determine if the MCA needs additional guidance to properly accrue for those costs.

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

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

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

EXHIBIT 1

Significant Deficiencies in Internal Controls

Contract Retentions reporting errors – For the first and second quarters of FY 2019, we found that an MCA had understated the amount reported for contract retentions by \$460,000 in quarter one and \$30,918 in quarter two. MCC did not identify the retention reporting errors and without written procedures to perform quality control verifications and hold MCAs accountable, MCC cannot gain assurance that the data reported is accurate.

Grant accrual liability reporting errors – Grant accrual estimates prepared by MCAs include estimated works completed by vendors but not yet invoiced for payments by MCAs. For the first and second quarters of FY 2019, we found one MCA did not properly exclude the advances liquidation amounts for several contracts from the reported grant accrual amounts for \$115,759 in quarter one and \$50,513 in quarter two, resulting in an overstatement of grant accrual liability. For another MCA, we identified the reported grant accrual amounts for quarter two was overstated by \$367,266. The reporting errors were due to the MCA not having effective controls in place to identify and exclude vendor invoices already paid from the reported grant accrual amounts and inadequate MCC guidance to the MCAs that does not fully incorporate the MCA Fiscal Agent in the grant accrual estimate process.

In-House invoices reporting errors – Grant accrual estimates prepared by MCAs also include vendor invoices received by the MCAs (called in-house invoices) for goods and services received from vendors but not yet paid. For the first and second quarters of FY 2019, we found that selected MCAs disclosed reporting errors and incomplete data. For example, for the first quarter, an MCA did not exclude the advances liquidation amounts from an in-house invoice. For another MCA, we found that an in-house invoice should not have been included in the data call. In another instance, for the second quarter, two MCAs understated their in-house invoices by incorrectly omitting the invoices in the data call. Collectively, the reporting errors identified were due to MCAs not having sufficient internal controls for ensuring accuracy and completeness of the data reported, which resulted in misstatement of the expenses and accrued liabilities and deficiency in MCC's control to detect the reporting error as part of its review process.

Annual audit delays – The Accountable Entity (AE or MCA), under the terms of the compact or threshold agreement, is required to undergo annual and in some cases semi-annual financial audits of all MCC funding disbursements. Audit reports are due no later than 90 days after the applicable audit periods, or such other period as MCC and the MCA may otherwise agree to in writing. For compact closure audits, the audit reports are due no later than 150 days after compact end date (CED). Our audit identified five compacts and one threshold where annual audits were not timely conducted. For four of the five compacts, MCAs with concurrence of MCC increased the audit periods from six months or a year to one year and six months and as long as three years and ten months. Even after expanding the audit periods, the audit reports continue to be late in issuance ranging from 107 to 343 days late. Below illustrate the extent of the late audit reports.

EXHIBIT 1
Significant Deficiencies in Internal Controls

Accountable Entity	Audit Period	Audit Report Due Date	Report Issued	Days Late
Compact #1 ¹	Oct. 1, 2016 – March 31, 2018	June 29, 2018	June 7, 2019	343
Compact #2	Feb. 4, 2015 – Sept. 30, 2018	Dec. 29, 2018	June 20, 2019	173
Threshold #1	Oct. 1, 2017 – Sept. 30, 2018	Dec. 29, 2018	April 15, 2019	107
Compact #3	Compact End Date Sept. 20, 2018	Feb. 17, 2019	Oct. 9, 2019	233

Accountable Entity²	Audit Period	Time Lapsed Without an Audit
Compact #4	Nov. 30, 2015 – Sept. 30, 2019	3 year, 10 months
Compact #5	Sept. 14, 2017 – Sept. 30, 2019	2 years, 17 days

MCC was unable or provided no explanation as to why the audits were deferred for compacts #1 and #5. For compacts #2 and #4, the causes indicated were a decision by the MCAs to defer the audit due to low rate of compact disbursements, a failed audit procurement, procedural delays in signing the audit contract, and delays in getting the MCA Procurement Agent in place. Financial audit is a key control for MCC to obtain assurance that the MCAs' funds are being used appropriately and implemented financial recording and reporting controls over the compact or threshold funds are working as intended. Delays in the required audits increase the risk that potential fraud, waste, and abuse may not be detected. In addition, it will delay appropriate corrective actions and timely recovery of questioned costs. Furthermore, for compact #3 that closed out at end of 2018, the audit delay hindered other key closure processes required to de-obligate \$2.7 million in compact funds remaining. MCC is responsible for monitoring and ensuring that the required MCA audits are performed in a timely manner and that all required audits are completed with audit reports issued no later than 90 days after the end period except for close out audits, which are due no later than 150 days after CED.

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

Recommendation 3. Update the "Retentions Data Call: Millennium Challenge Account Guidance" to provide additional requirements for MCAs to reconcile retention balances reported in the quarterly data calls with the relevant balances recorded in the MCAs' financial system and

¹ No audit reports were provided to us concerning funding disbursement period from April 1, 2018 to March 31, 2019.

² The scheduled audit represents the first audit for these compacts.

EXHIBIT 1
Significant Deficiencies in Internal Controls

investigate any variances noted, and submit this reconciliation along with the quarterly data call to MCC for review.

Recommendation 4. We recommend that the Vice President of Administration and Finance/CFO coordinate with the Vice President of Department of Compact Operations the updating of the “Fiscal Accountability Plans” to:

- Require MCAs to develop an internal process with Project Directors and Engineers on how to capture work completed but not yet billed or paid and document in a desktop procedure manual.
- Require MCAs to ensure that the Fiscal Agent is integrated within the grant accrual process to verify when grant accruals have been paid and should no longer be reported as an accrual in the data call.

Recommendation 5. Provide MCAs with additional training concerning the reporting of advance liquidations in the grant accrual process for in-house invoices and works completed but not invoiced as of quarter end.

Recommendation 6. Develop, implement, and document procedures for how MCC will assist the MCAs to enable them to meet the compact/threshold audit requirements.

EXHIBIT 2 Management's Response to Audit Findings



November 15, 2019

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

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

Dear Ms. Leswing and Mr. Brown,

In response to the audit findings and recommendations cited in the "Audit of MCC's Financial Statements, Internal Controls, and Compliance for the Fiscal Years Ending September 30, 2019 and 2018" report, MCC provides the following comments:

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

Recommendation 1. Update the "Grant Accrual Financial Management Division Desktop Procedures" to document and determine what MCC should do with validated costs identified that were not part of the accrued costs, and what was the root cause of the initial omission by MCA. Based on that outcome, MCC should revise MCA guidance as appropriate or provide additional training to prevent recurrence.

Recommendation 2. Update the "Grant Accrual Financial Management Division Desktop Procedures" to require MCC to review the adequacy of the MCAs' procedure manual that addresses the MCA internal process with its project directors and engineers for capturing work completed but not yet billed or paid. MCC should provide recommendations for improvement where warranted.

Recommendation 3. Update the "Grant Accrual Financial Management Division Desktop Procedures" to address and document what additional steps should be taken to ensure the reliability of the grant accrual estimate and the validation process when the compact is entering into its final year and or closure period (i.e., 120 days after the compact end date).

EXHIBIT 2

Management's Response to Audit Findings

Recommendation 4. Develop, document, and implement an internal procedure that requires the Department of Compact Operations to disclose unique financial aspects of the compact, or additional financial agreements impacting the compact, to the Financial Management Division for review to determine if the MCA needs additional guidance to properly accrue for those costs.

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

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

Recommendation 5. Update the "Retentions Data Call: Millennium Challenge Account Guidance" to provide additional requirements for MCAs to reconcile retention balances reported in the quarterly data calls with the relevant balances recorded in the MCAs' financial system, investigate any variances noted, and submit this reconciliation with the quarterly data call to MCC for review.

Recommendation 6. Coordinate with the Vice President of Department of Compact Operations the updating the "Fiscal Accountability Plans" to require MCAs to develop an internal process with project directors and engineers on how to capture work completed but not yet billed or paid, and document in a desktop procedure manual.

Recommendation 7. Coordinate with the Vice President of Department of Compact Operations the updating the "Fiscal Accountability Plans" to require MCAs to ensure that the Fiscal Agent is integrated within the grant accrual process to verify when grant accruals have been paid and should no longer be reported as an accrual in the data call.

Recommendation 8. Provide MCAs with additional training concerning the reporting of advance liquidations in the grant accrual process for in-house invoices and works completed but not invoiced as of quarter end.

Recommendation 9. Develop, implement, and document procedures for how MCC will assist the MCAs to enable them to meet the compact/threshold audit requirements.

MCC Response: MCC concurs with the recommendations 5, 6, 7, 8 and 9. A comprehensive corrective action plan will be developed to address the deficiency noted.

EXHIBIT 2
Management's Response to Audit Findings

Sincerely,

A handwritten signature in blue ink, appearing to read 'Ken Jackson', with a long horizontal flourish extending to the right.

Ken Jackson
Vice President and Chief Financial Officer
Department of Administration and Finance

EXHIBIT 3
Status of Prior Year Recommendations

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

<i>FY 2018 Recommendations</i>	<i>Type</i>	<i>Fiscal Year 2019 Status</i>
1. Update the “Expense Accruals Financial Management Division Procedure Manual” to reflect the current grant accrual methodology.	Significant Deficiency (SD)	Closed
2. Provide Millennium Challenge Accounts with written guidance on developing grant accrual estimates to ensure validity of the grant accruals estimate. The guidance should include, but not be limited to, the following: <ul style="list-style-type: none"> • Take into consideration the impact of contract advances and retentions for large works contracts in the accrual estimate. • Ensure that accrual estimates do not include costs that will not be paid with compact funds. • Consider historical questioned costs for contracts and grants that are significant in developing the accrual estimate. 	SD	Closed
3. Update the “Compact Grant Accrual Validation Data Call Desktop Manual” to include a time requirement for MCC to perform follow up with Millennium Challenge Accounts so that errors in accrual estimates or validations are promptly identified and addressed.	SD	Open
4. Provide Millennium Challenge Accounts with written guidance to ensure that the Millennium Challenge Accounts perform grant accrual validation correctly to include, but not be limited to, validation of consultant contract costs.	SD	Closed

EXHIBIT 3
Status of Prior Year Recommendations

<p>5. Develop clear and complete written guidance for the Millennium Challenge Accounts' internal control over the data call process, provide effective training, and monitor the effectiveness of the internal control.</p>	<p style="text-align: center;">SD</p>	<p style="text-align: center;">Open</p>
<p>6. Develop, document, and implement a process to oversee and verify that the accountable Government entities conduct pre-Millennium Challenge Accounts compact procurements in accordance with the compact agreement and the Program Procurement Guidelines.</p>	<p style="text-align: center;">SD</p>	<p style="text-align: center;">Closed</p>
<p>7. Update MCC's Program Procurement Guidelines to require the Millennium Challenge Accounts to document alternative procurement procedures so that all parties are aware of what is required, who is accountable for what, and how the procurement will be documented.</p>	<p style="text-align: center;">SD</p>	<p style="text-align: center;">Open</p>
<p>8. Develop, document, and implement policies and procedures for MCC's management oversight of transfer and retention of pre-Millennium Challenge Accounts compact procurement and related documents to the Millennium Challenge Accounts.</p>	<p style="text-align: center;">SD</p>	<p style="text-align: center;">Closed</p>
<p>9. Inform the Millennium Challenge Accounts that the U.S. State Department's Terrorist Exclusion List should be documented separately, for all currently active awards and future awards, and update MCC's vendor eligibility verification guidance provided to the Millennium Challenge Accounts for completeness and accuracy.</p>	<p style="text-align: center;">SD</p>	<p style="text-align: center;">Open</p>
<p>10. Identify the Millennium Challenge Accounts who are late with the vendor invoice payments, determine the reasons/causes for late payments, implement corrective actions, and monitor effectiveness of the corrective actions.</p>	<p style="text-align: center;">SD</p>	<p style="text-align: center;">Open</p>