



Millennium Challenge Corporation

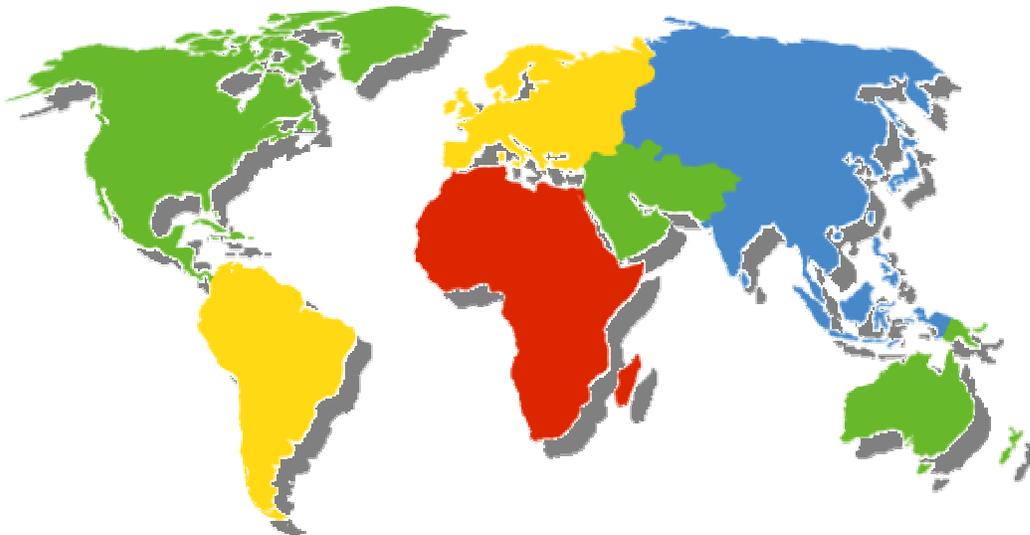
Reducing Poverty Through Growth

OFFICE OF INSPECTOR GENERAL

Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Nine Month Period Ending September 30, 2004

Report No. M-000-05-001-C

January 27, 2005



Washington, D.C.



Millennium Challenge Corporation

Reducing Poverty Through Growth

January 27, 2005

MEMORANDUM

TO: Paul V. Applegarth, Chief Executive Officer, Millennium Challenge Corporation

FROM: Henry L. Barrett, AIG/MCC /s/

SUBJECT: Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Nine Month Period Ending September 30, 2004 (Report No. M-000-05-001-C)

Enclosed is the final report on the subject audit. The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of Williams, Adley and Company, LLP (WA & Co.) to audit the financial statements of the Millennium Challenge Corporation (MCC) for the nine month period ended September 30, 2004. The contract required that the audit be performed in accordance with generally accepted auditing standards; generally accepted government auditing standards; and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

In its audit of the MCC's financial statements for the nine month period ended September 30, 2004, the WA & Co. auditors found;

- that the financial statements were fairly presented in conformity with U.S. generally accepted accounting principles,
- a reportable condition in MCC's internal controls, and
- an instance of noncompliance related to the review of its financial and accounting system.

The Millennium Challenge Corporation (Corporation) does not have its own financial system. The Corporation contracted with the Department of Interior, National Business Center (NBC) to provide accounting and IT services including usage of its Oracle Federal Financials System application. However, the NBC has not conducted an internal control review, such as a Statement of Auditing Standards (SAS) 70 review, of the Oracle Federal Financials System nor has MCC requested NBC to do such a review.

Furthermore, WA & Co. LLP considered that as a result of the above situation the Corporation's financial management system was not in substantial compliance with the Federal financial management system requirements required under the Federal Financial Management Improvement Act (FFMIA) of 1996 and OMB Circular A-127, *Federal Financial System Requirements*.

In carrying out its oversight responsibilities, the OIG reviewed WA & Co.'s report and related audit documentation. This review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable the OIG to express, and we do not express, opinions on MCC's financial statements or internal control; on whether MCC's financial management systems substantially complied with FFMIA; or on MCC's compliance with other laws and regulations. WA & Co. is responsible for the attached auditors' report, dated January 6, 2005, and the conclusions expressed in the report. However, our review disclosed no instances where WA & Co. did not comply, in all material respects, with applicable standards.

Because of the internal control weakness and the compliance finding reported, we are making the following recommendation to MCC's management:

Recommendation No. 1: We recommend that the Millennium Challenge Corporation (MCC) require the National Business Center to conduct an internal control review, such as a SAS 70 review, to assess the control environment of the Oracle Federal Financials System used to process MCC's financial transactions.

In finalizing the report, we considered your comments on our draft report and included those comments, in their entirety in Appendix I of this report. Based on MCC's comments, we consider that a management decision has been reached on Recommendation No. 1. MCC should inform the OIG when final action has been taken.

The OIG appreciates the cooperation and courtesies extended to our staff and to the staff of WA & Co. during the audit.

**Table of
Contents**

Management’s Discussion and Analysis	5
Independent Auditors’ Report.....	15
Statement of Financial Position	17
Statement of Operations and Changes in Net Position.....	18
Statement of Functional Expenses	19
Statement of Cash Flows	20
Statement of Budgetary Resources	21
Notes to the Financial Statements.....	23
Independent Auditors’ Report On Internal Control Over Financial Reporting.....	29
Independent Auditors’ Report On Compliance With Laws and Regulations.....	33
Management Comments and our Evaluation	35
Appendix I – Management Comments	37

This page intentionally left blank

MANAGEMENT'S DISCUSSION AND ANALYSIS

“We must tie greater aid to political and legal and economic reforms. And by insisting on reform, we do the work of compassion. The United States will lead by example.”

President George W. Bush, Monterrey, Mexico March 22, 2002

With his announcement in Monterrey, President Bush launched a major new commitment by the United States to bring hope and opportunity to the world's poorest people. In proposing the Millennium Challenge Account (MCA) and the Millennium Challenge Corporation (MCC), the organization that would oversee and manage the account, President Bush made clear that this program would be unlike any other in America's long history of foreign assistance. Along with significant new resources to fight world poverty, the President promised we would insist on the reforms necessary to make this a fight we could win.

With strong bipartisan support, Congress established the Millennium Challenge Corporation on the 23rd of January 2004, authorized the MCC to administer the MCA and provided \$1 billion in initial funding for FY 2004. President Bush has pledged to increase funding for the MCA to \$5 billion a year, roughly a 50 percent increase over then current U.S. core development assistance.

The MCA draws on lessons learned about development over the past 50 years:

1. Aid is most effective when it reinforces sound political, economic and social policies - which are key to encouraging the inflows of private capital and increased trade - the real engines of economic growth;
2. Development plans supported by a broad range of stakeholders, and for which countries have primary responsibility, engender country ownership and are more likely to succeed;
3. Integrating monitoring and evaluation into the design of activities boosts effectiveness, accountability, and the transparency with which taxpayer resources are used.

Mission, Key Principles and Organizational Structure

Mission: MCC's mission is to “Reduce Poverty through Economic Growth.” The MCC will focus specifically on promoting sustainable economic growth that reduces poverty through investments in areas such as agriculture, education, private sector development, and capacity building.

Key Principles: The MCA is governed by the following key principles:

- **Reward Good Policy:** Using objective indicators, countries will be selected to receive assistance based on their performance in governing justly, investing in their citizens, and encouraging economic freedom.
- **Operate in Partnership:** Working closely with the MCC, countries that receive MCA assistance will be responsible for identifying the greatest barriers to their own development, ensuring civil society participation, and developing an MCA program. MCA participation will require a high-level commitment from the host government. Each MCA country will enter into a public Compact with the MCC that includes a multi-year plan for achieving shared development objectives and identifies the responsibilities of each partner in achieving those objectives.
- **Focus on Results:** MCA assistance will go to those countries that have developed well-designed programs with clear objectives, benchmarks to measure progress, procedures to ensure fiscal accountability for the use of MCA assistance, and a plan for effective monitoring and objective evaluation of results. Programs will be designed to enable progress to be sustained after the funding under the MCA Compact has ended.

Organization: The MCC is managed by a Chief Executive Officer appointed by the President and confirmed by the Senate and overseen by a Board of Directors composed of the Secretary of State, the Secretary of Treasury, the U.S. Trade Representative, the Administrator of USAID, the CEO of the MCC and four public members,¹ appointed by the President with the advice and consent of the Senate. The Secretary of State is the Chairman of the Board. The MCC, which administers the MCA, is designed to support innovative strategies and to ensure accountability for measurable results. Accordingly, the Corporation was designed to make maximum use of flexible authorities to optimize efficiency in contracting, program implementation, and personnel.

MCC's internal organization is comprised of the Chief Executive Officer and eight vice-Presidencies:

- (1) Office of the Chief Executive Officer: responsible for managing the operations in a manner that reflects policies of the Board of Directors and also achieves MCC's objectives in accordance with applicable laws and regulations and Congressional directives.

¹ Two public members, Kenneth Hackett, president of Catholic Relief Services, and Governor Christine Todd Whitman, who served as Administrator of the Environment Protection Agency, were named and confirmed in July 2004.

- (2) General Counsel: Responsible for and directs all attorneys, agents and employees in the performance of all legal duties and services for and on behalf of MCC. This office is responsible for all legislative matters and maintains MCC's records.
- (3) Administration and Finance: Responsible for all matters pertaining to the Corporation's financial, administrative, information technology, procurement, and human resource management policies and procedures.
- (4) Country Relations: Responsible for managing assistance and the development of compacts. Manages the communications with eligible countries leading to the country's submission of a proposal. It provides advice to the countries about their proposals, plays a coordination role after the proposals are submitted and will coordinate the negotiation of compacts with individual countries.
- (5) Markets and Sectoral Assessments: Responsible for evaluating country proposals to ensure that the projects that the countries propose are feasible and will lead to poverty reduction through economic growth. This office is also responsible for reviewing the financial and procurement systems in each country.
- (6) Domestic Relations: Responsible for all domestic and international communications concerning MCC. This office collects and disseminates information to all key stakeholders.
- (7) Monitoring and Evaluation: Responsible for developing and administering the corporation's monitoring and evaluation program.
- (8) Development Policy: Responsible for defining MCC's policies and procedures, gathering data on the countries, and developing briefing materials.
- (9) International Relations: Responsible for developing and maintaining mutually beneficial relationships with international organizations.

PERFORMANCE GOALS, OBJECTIVES AND RESULTS FOR FY 2004

During the start up phase or the first nine months of its operations, or the period ending September 30, 2004, MCC's key goals were to:

Objective 1: Establish an enabling administrative and operational environment.

Performance Measures:

- i. Office space rented, contracts executed for fundamental operational services such as accounting, information technology, contracting, and, travel services.
- ii. Organizational structure and staffing plan developed, and 60 positions filled.

Results: The MCC has successfully met all the performance measures identified above. MCC's temporary headquarters was established in Rosslyn, Virginia, with space rented from the Department of State. It is anticipated that MCC will relocate to Washington, DC in the summer of 2005. During its start up phase, MCC outsourced

its financial management, human resources, contract and travel management functions to the Department of Interior's National Business Center.

On September 30, 2004, MCC had a total staff, including contractors of 61 people.² MCC ambitious staffing plan calls for a total staff of 150 to 200 employees by the end of FY 2005, and accordingly, MCC has hired a recruitment firm to assist it in meeting this important goal.

Objective 2: Meet the legal requirements specified in the Millennium Challenge Act and develop a process for providing program support.

Performance Measures:

- i. Eligible candidate countries for FY 2004 and FY 2005 funding identified, Congress notified, and, list published in the Federal Register.
- ii. Criteria and methodology for selecting eligible countries in FY 2004 and FY 2005 established, results published, and one or more public hearings held.
- iii. Eligible countries for FY 2004 funding identified, report provided Congress and published in the Federal Register.

Results: MCC developed the candidate country list, which included 63 and 70 countries respectively, for FY 2004 and FY 2005, notified Congress and published the report in the Federal Register, all within the specified time frames³ in the Act. Similarly, MCC developed the selection criteria and methodology and held four public hearings to solicit comment and facilitate understanding. On May 6, 2004, the Board selected 16 countries as eligible to apply for MCA financing in FY 2004; a report was submitted to Congress and published in the Federal Register. MCC also conducted public hearings to explain the results. Within weeks of this selection, MCC delegations visited the selected countries to explain MCA and invited these countries to submit proposals. MCC received 10 proposals and concept papers before the end of the fiscal year. MCC has clearly met this objective.

Objective 3: Coordinate with the United States Agency for International Development (USAID).

Performance Measures:

- i. Threshold program developed.
- ii. Memorandum of understanding signed with USAID.

Results: The MCC, in close coordination with USAID, developed a Threshold program and executed a memorandum of Understanding in September 2004, thereby meeting this objective.

² Includes 51 direct hire staff and 10 contractors.

³ One report was submitted two days late.

MCC's FINANCIAL STATEMENTS

The financial statements, presented herein, have been prepared to report the financial position and results of operation of MCC, pursuant to the requirements of 31 U.S.C. 3515 (b). While these statements have been prepared from the books and records of MCC in accordance with generally accepted accounting principles (GAAP) for Federal entities and the formats prescribed by the Federal Accounting Standards Advisory Board (FASAB), the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. As such, these statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. MCC's financial statements for the nine months ended September 30, 2004 reflect a classic start up organization, where the program or business purpose has not been implemented from a financial perspective. MCC has three costs centers: Program, Administration and Audit.

The financial statements however provide a glimpse of MCC's evolving character, a lean corporation that manages a substantial development investment fund, with limited human resources. MCC's objective is to maximize the use of its human resource capital to further its business objectives and accordingly, the bulk of its back office operations, such as financial, information technology and human resource management have been outsourced. MCC's key administrative costs are staff salaries and benefits, travel, rent and operational services. It is anticipated that salaries and benefits will account for about 55 percent and travel, particularly those related to program due diligence and monitoring, will account for about 20 percent of all administrative costs. Audit services, provided by USAID's Inspector General's office, amounted to 7 percent of administrative costs in FY 2004 and is expected to consume a lower percentage of administrative costs in the future as MCC operations expand and the full contingent of staff is hired. No direct program funds were obligated or disbursed in FY 2004.

MCC'S SYSTEMS, CONTROLS AND LEGAL COMPLIANCE

MCC's strategy, given that: (i) it did not have a full complement of staff; (ii) had outsourced all its key administrative operational functions; and (iii) was developing its compact process, was to use outside resources to assess and validate its key internal control structures, instead of conducting an internal review of its internal control structures. The USAID Inspector General has issued a report based on a review it performed addressing the following:

- What progress has the Millennium Challenge Corporation made in achieving its planned organizational structure?
- What is the status of the Millennium Challenge Corporation's compact development process?

- What progress has the Millennium Challenge Corporation made in complying with the Millennium Challenge Act of 2003 and other applicable federal laws and regulations?

and, conducted reviews of:

- MCC's compliance with the Federal Information Security Management Act, and
- The external auditors, as a part and parcel of the present financial statement audit, have reviewed the Department of Interior's National Business Center and MCC internal control structures related solely to the MCC's financial statements.

These reviews and audits provide MCC with reasonable assurance as to the validity of the internal control systems and its ability to rely on them. MCC will be implementing the recommendations emanating from the above: (i) MCC recently developed its own information technology network and accordingly, will develop a security program as called for by the report; and, (ii) MCC has obtained assurance from the Department of Interior's National Business Center that they will be conducting a FISMA audit of the Oracle system in FY 2005.

MANAGEMENT CHALLENGES FACING MCC

There are many management challenges that face MCC. They include:

- (i) **Staffing:** MCC's ability to effectively perform its business function, which includes due diligence, compact negotiation, management and program monitoring, is dependent on the ability to rapidly hire staff. MCC has outsourced recruitment support and anticipates that this requirement will be met.
- (ii) **Integrated financial and management information system:** As a lean organization, MCC needs to make sure that its management information systems are responsive to the needs of its managers and that this information is readily accessible by its staff and partners. The financial management, human resources, and procurement systems used by MCC are not integrated, resulting in duplicative data entry, duplication of effort and loss of management information. MCC plans to standardize its operations on one integrated platform that would also provide a framework for managing its program resources. MCC has already begun discussions with NBC to determine if they are willing and able to support these key functions on the platform chosen by MCC. If not, MCC will have to look for other means of meeting this requirement.
- (iii) **Overseas risk:** MCC's business takes place in countries where risks are perceived to be higher. MCC's assistance modality and method of

implementation, where the foreign governments will generally manage the resources, is new and has not been tested, increasing potential risk. The developmental benefits of this approach, however, by far outweigh the risks, and MCC believes that this risk can be greatly reduced or mitigated with adequate due diligence and management controls.

This page intentionally left blank



MILLENNIUM CHALLENGE CORPORATION

Financial Statements

September 30, 2004

(With Independent Auditors' Report Thereon)

WILLIAMS, ADLEY & COMPANY, LLP

Management Consultants

and

Certified Public Accountants



WILLIAMS, ADLEY & COMPANY, LLP

Management Consultants
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

We have audited the accompanying Statement of Financial Position of the Millennium Challenge Corporation (Corporation) as of September 30, 2004, and the related Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources for the nine months ended September 30, 2004. These financial statements are the responsibility of Corporation management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial statement audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation at September 30, 2004, and cash flow for the nine months ended September 30, 2004, in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the basic financial statements of the Corporation taken as a whole. The information contained in the Management's Discussion and Analysis is not a required part of the financial statements

but is supplementary information required by the Federal Accounting Standards Advisory Board guidance. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the information. However, we did not audit the information and do not express an opinion thereon.

The accompanying Statement of Functional Expenses for the nine months ended September 30, 2004 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This statement is the responsibility of the management of Corporation. The information in this statement has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our reports dated January 6, 2005, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with provisions of laws and regulations. Our reports on internal control and compliance are an integral part of an audit conducted in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

This audit was performed pursuant to the Government Corporation Control Act, and is intended solely for the information and use of the United States Congress, the President, the Director of the Office of Management and Budget, the Comptroller General of the United States, the Corporation and its Inspector General. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Williams, Adley & Company, LLP

January 6, 2005
Washington, DC

Millennium Challenge Corporation
Statement of Financial Position
As of September 30, 2004

	<u>Total</u>	<u>Program</u>	<u>Administrative</u>	<u>Audit</u>
Assets				
Fund Balance with Treasury (Note 2)	\$ 989,816,579	\$ 986,171,577	\$ 3,288,818	\$ 356,184
Prepayments (Note 3)	168,599	-	168,599	-
Total Assets	\$ 989,985,178	\$ 986,171,577	\$ 3,457,417	\$ 356,184
Liabilities				
Accounts Payable	\$ 23,884	\$ -	\$ 23,884	\$ -
Other Liabilities (Note 4)	854,625	-	498,441	356,184
Accrued Unfunded Annual Leave	169,901	-	169,901	-
Total Liabilities	\$ 1,048,410	\$ -	\$ 692,226	\$ 356,184
Net Position				
Unexpended Appropriations				
Obligated	\$ 2,765,191	\$ -	\$ 2,765,191	\$ -
Unobligated	986,171,577	986,171,577	-	-
Cumulative Results of Operations	-	-	-	-
Total Net Position (Note 5)	\$ 988,936,768	\$ 986,171,577	\$ 2,765,191	\$ -
Total Liabilities and Net Position	\$ 989,985,178	\$ 986,171,577	\$ 3,457,417	\$ 356,184

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statement of Operations and Changes in Net Position
For the nine month ended September 30, 2004

	<u>Total</u>	<u>Program</u>	<u>Administrative</u>	<u>Audit</u>
Revenues				
Appropriations Used	\$ 5,163,232	\$ -	\$ 4,807,048	\$ 356,184
Expenses	<u>\$ 5,163,232</u>	<u>\$ -</u>	<u>\$ 4,807,048</u>	<u>\$ 356,184</u>
Excess of Revenues over Expenses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Net Position				
Excess of Revenues over Expenses	\$ -	\$ -	\$ -	\$ -
Increase in Unexpended Appropriations				
Obligated	2,765,191	-	2,765,191	-
Appropriated	992,071,577	992,071,577	-	-
Permanent Recission	(5,900,000)	(5,900,000)	-	-
Unobligated	<u>986,171,577</u>	<u>986,171,577</u>	<u>-</u>	<u>-</u>
Total Increase in Unexpended Appropriations	988,936,768	986,171,577	2,765,191	-
Beginning Net Position - January 23, 2004	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Ending Net Position - September 30, 2004	<u>\$ 988,936,768</u>	<u>\$ 986,171,577</u>	<u>\$ 2,765,191</u>	<u>\$ -</u>

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statement of Functional Expenses
For the nine month period ended September 30, 2004

	<u>Total</u>	<u>Program</u>	<u>Administrative</u>	<u>Audit</u>
Salary and Benefits	\$ 2,185,333	\$ -	\$ 2,013,058	\$ 172,275
Travel	460,463		443,508	16,955
Rent/Lease	322,833		322,833	
Utilities	170,241		170,241	
Information Technology Services	502,286		502,286	
Accounting Services	316,496		316,496	
Other Services	893,483		726,529	166,954
Supplies and Equipment	102,368		102,368	
Miscellaneous	209,729		209,729	
	<u>\$ 5,163,232</u>	<u>\$ -</u>	<u>\$ 4,807,048</u>	<u>\$ 356,184</u>

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statement of Cash Flows
For the nine month period ended September 30, 2004

	Total	Program	Administrative	Audit
Cash Flows from Operating Activities				
Excess of Revenues over Expenses	\$ -	\$ -	\$ -	\$ -
Adjustments Affecting Cash Flow:				
Appropriated Capital Used	\$ (5,163,232)	\$ -	\$ (4,807,048)	\$ (356,184)
Increase in Prepayments	(168,599)	-	(168,599)	-
Increase in Accounts Payable	23,884	-	23,884	-
Increase in Other Liabilities	854,625	-	498,441	356,184
Increase in Unfunded Annual Leave Liabilities	169,901	-	169,901	-
Total Adjustments	\$ (4,283,421)	\$ -	\$ (4,283,421)	\$ -
Net Cash Generated by Operating Activities	\$ (4,283,421)	\$ -	\$ (4,283,421)	\$ -
Cash Flows from Financing Activities				
Appropriations Received Net of Recissions	\$ 994,100,000	\$ 986,171,577	\$ 7,572,239	\$ 356,184
Fund Balance with Treasury, Beginning	\$ -	\$ -	\$ -	\$ -
Fund Balance with Treasury, Ending	\$ 989,816,579	\$ 986,171,577	\$ 3,288,818	\$ 356,184

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statement of Budgetary Resources
For the nine month ended September 30, 2004

	<u>Total</u>	<u>Program</u>	<u>Administrative</u>	<u>Audit</u>
Budgetary Resources:				
Budget Authority:				
Appropriations	\$ 1,000,000,000	\$ 992,071,577	\$ 7,572,239	\$ 356,184
Net Transfer, Current Year Authority	-			
Unobligated Balance - Beginning of Period	-			
Unobligated Balance - Transferred	-			
Spending Authority from Offsetting Collections	-			
Advances Received	-			
Adjustments:				
Recoveries of Prior Years Obligations	-			
Permanently Not Available (Note 6)	(5,900,000)	(5,900,000)		
Total Budgetary Resources	<u>\$ 994,100,000</u>	<u>\$ 986,171,577</u>	<u>\$ 7,572,239</u>	<u>\$ 356,184</u>
Status of Budgetary Resources:				
Obligations Incurred	\$ 7,928,423	\$ -	\$ 7,572,239	\$ 356,184
Unobligated Balance Available:				
Apportioned	986,171,577	986,171,577		
Unobligated Balance Not Available:	-			
Total Status of Budgetary Resources	<u>\$ 994,100,000</u>	<u>\$ 986,171,577</u>	<u>\$ 7,572,239</u>	<u>\$ 356,184</u>
Relationship of Obligations to Outlays:				
Obligated Balance, Net - Beginning of Period	\$ -	\$ -	\$ -	\$ -
Obligations Incurred	7,928,423	-	7,572,239	356,184
Recoveries of Prior Years Obligations	-			
Adjustments				
Obligated Balance, Net - End of Period				
Accounts Payable	(1,048,410)		(692,226)	(356,184)
Undelivered Orders	(2,596,592)		(2,596,592)	
Total Outlays	<u>\$ 4,283,421</u>	<u>\$ -</u>	<u>\$ 4,283,421</u>	<u>\$ -</u>
Outlays:				
Disbursements	4,283,421	-	4,283,421	-
Collections / Refunds	-			
Net Outlays	<u>\$ 4,283,421</u>	<u>\$ -</u>	<u>\$ 4,283,421</u>	<u>\$ -</u>

The footnotes are an integral part of these financial statements

This page intentionally left blank

Millennium Challenge Corporation
Footnotes
(As of September 30, 2004)

Note 1 – Summary of Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position, results of operations, cash flows, and budgetary resources for the Millennium Challenge Corporation (the Corporation), as required by Section 613 of the Millennium Challenge Act of 2003. The Corporation was formed on January 23, 2004. These financial statements have been prepared from the books and records of the Corporation in accordance with generally accepted accounting principles (according to the Federal Accounting Standards Advisory Board, or FASAB) for the period January 23, through September 30, 2004. The Corporation is not subject to income tax.

The principal financial statements of the Corporation are the:

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

The notes to the financial statements are considered an integral part of the financial statements.

B. Reporting Entity

The Corporation was created by the Millennium Challenge Act of 2003 (Public Law 108-199). The Corporation provides United States assistance for global development. This assistance is provided in such a manner as to provide economic growth and the elimination of extreme poverty and strengthens good governance, economic freedom, and investments in people.

C. Budgets and Budgetary Accounting

The activities of the Corporation are funded through an appropriation with indefinite expiration (no-year funds). For FY 2004, \$1 billion was initially appropriated. This appropriation funds both the cost of administrative operations, and any grants, compacts or contracts with eligible entities.

D. Basis of Accounting

Transactions are recorded in the accounting system on an accrual basis and a budgetary basis. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash.

The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of Federal funds. Budgetary accounting principles are designed to recognize the obligation of funds according to legal requirements, which in many cases is prior to the occurrence of an accrual-based transaction. Thus, the financial statements differ from other financial reports submitted pursuant to Office of Management and Budget directives for the purpose of monitoring and controlling the use of the Corporation's budgetary resources.

E. Fund Balance with Treasury

The Corporation does not maintain cash in commercial bank accounts. The U.S. Treasury processes all cash receipts and disbursements for the Corporation. The Fund Balance with Treasury represents no-year funds, which are maintained in appropriated funds that are available to pay current and future commitments.

F. Advances to Others

The Corporation advances funds, primarily in response to grantee drawdown requests, to facilitate completion of any approved grant or contract.

G. Property and Equipment

The Corporation capitalizes property and equipment at historical cost for acquisitions of \$25 thousand or more, with an estimated useful life of two or more years. These assets can include telephone equipment, computer systems equipment, copiers, computer software, furniture, and assets under capital leases. These assets are depreciated (or amortized) over estimated useful lives ranging from two to ten years, using the half-year convention. Normal maintenance and repair costs on capitalized property and equipment are expensed when incurred.

H. Grants Payable

Grants are made to eligible countries with an approved Compact. Grants become budgetary obligations, but not liabilities, when they are awarded. At the end of each fiscal year, the Corporation reports the total amount of unreimbursed authorized grantee expenses, earned under the terms of the Compact, as grants payable.

I. Accounts Payable

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

J. Actuarial FECA Liability

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

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

Because 2004 is the first year of limited operation for the MCC, there are no FECA liabilities incurred or reflected on the statements.

K. Other Liabilities

Other liabilities included amounts owed but not paid at the end of the fiscal year for payroll and benefits.

L. Accrued Annual Leave

Annual leave is accrued as a liability based on amounts earned but not used as of the fiscal year-end. Each year, the balance in the accrued annual leave account is adjusted to reflect current year pay rates and leave balances. Annual leave is funded from current appropriations when used. As unused annual leave is used in the future, financing will be obtained from appropriations current at that time. Sick leave and other types of non-vested leave are expensed when used.

M. Net Position

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

N. Revenues

The Corporation obtains funding for 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 such as earned but unused annual leave. Appropriations expended for property and equipment are recognized as a financing source when the property is purchased.

O. Retirement Benefits

The Corporation's employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). FERS was established by the enactment of Public Law 99-335. Pursuant to this law, FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees hired prior to January 1, 1984, elected to join FERS and Social Security or remained in CSRS.

For employees covered by CSRS, the Corporation contributes 8.51 percent of their gross pay towards retirement. For those employees covered by FERS, the Corporation contributes 11.50 percent of their gross pay towards retirement. Employees are allowed to participate in the Federal Thrift Savings Plan (TSP). For employees under FERS, the Corporation contributes an automatic one percent of basic pay to TSP and matches employee contributions up to an additional four percent of pay, for a maximum Corporation contribution amounting to five percent of pay. Employees under CSRS may participate in the TSP, but will not receive either the Corporation's automatic or matching contributions.

The Corporation made retirement contributions of \$5 thousand to the CSRS Plan and \$117 thousand and \$20 thousand to the FERS and TSP Plans in fiscal year 2004.

P. Use of Estimates

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

Q. Contingencies

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

outstanding or threatened, which would materially impact the financial statements of the Corporation.

R. Judgment Fund

Certain legal matters to which the Corporation can be named as a party may be administered and, in some instances, litigated and paid by other Federal agencies. Generally, amounts paid in excess of \$2.5 thousand for Federal Tort Claims Act settlements or awards pertaining to these litigations are funded from a special appropriation called the Judgment Fund. Although the ultimate disposition of any potential Judgment Fund proceedings cannot be determined, management does not expect any liability or expense that might ensue would be material to the Corporation's financial statements.

S. Donated Services

The Corporation utilized donated services from other Federal agencies during the period of establishment for the Corporation. The dollar amount of these donated services is immaterial to these statements.

Note 2 – Fund Balance with Treasury

The U.S. Treasury accounts for all US Government cash on an overall consolidated basis. The Fund Balance with Treasury line on the Statement of Financial Position consists of the following:

Fund Balance with Treasury as of September 30 (In Dollars)

	2004
Appropriated Funds	
Unobligated	\$ 986,171,577
Obligated	\$ 3,645,002
Total	\$ 989,816,579

Note 3 – Prepayments

The prepayment reflects a prepaid lease on office space with the U.S. Department of State.

Note 4 – Other Liabilities

**Other Liabilities as of September 30
(In Dollars)**

2004	
Type	Amount
Accrual	
Office of the Inspector General	\$ 356,184
Payroll	\$ 330,216
Travel	\$ 81,001
Miscellaneous	\$ 87,224
Total	\$ 854,625

Note 5 – Net Position

The reported net position consists of unexpended appropriations and cumulative results of operations (cumulative results of operations represents the differences between revenues and expenses since the Corporation's inception).

**Net Position as of September 30
(In Dollars)**

2004	
	Appropriated Fund
Unexpended Appropriations	\$ 988,936,768
Cumulative Results of Operations	\$ 0
Total Net Position	\$ 988,936,768

Note 6 – Permanent Rescission

In fiscal year 2004, \$5.9 million of amounts previously appropriated under the 2004 Foreign Operations, Export Financing, and Related Programs Appropriations Act (Public Law 108-199) were rescinded. This rescission was part of the Across-the-Board Rescission, 2004.



WILLIAMS, ADLEY & COMPANY, LLP

Management Consultants
Certified Public Accountants

**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING**

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

We have audited the Statement of Financial Position of the Millennium Challenge Corporation (Corporation) as of September 30, 2004, and the related Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources for the nine months ended September 30, 2004, and have issued our report thereon dated January 6, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing the September 30, 2004 audit, we considered the Corporation's internal control over financial reporting by obtaining an understanding of the Corporation's internal control, determining if internal control had been placed in operation, assessing control risk, and performing tests of internal controls to determine our auditing procedures for the purpose of expressing an opinion on the financial statements. We limited internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on the Corporation's internal control over financial reporting. Consequently, we do not provide an opinion thereon.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls over financial reporting that, in our judgment, could adversely affect the Corporation's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected.

We noted one matter involving internal control over financial reporting and its operation that we consider to be a reportable condition. We do not consider this reportable condition to be a material weakness.

Review of Oracle Federal Financials System

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

The Federal Financial Management Improvement Act financial system requirements state that a system should comply with OMB Circular A-127, *Federal Financial System Requirements*. The Circular requires an agency to conduct an internal control review of all federal financial systems in accordance with FMFIA. By not completing an internal control review of the financial system, management does not have a comprehensive understanding of the system's internal controls and the risk involved in conducting system transactions. Per the Corporation, they are the first organization to use the system. It is a new system for NBC.

Recommendation

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

We also noted other matters involving internal control and its operation that we will report to Corporation management in our management letter.

This audit was performed pursuant to the Government Corporation Control Act, and is intended solely for the information and use of the United States Congress, the President, the Director of the Office of Management and Budget, the Comptroller General of the United States, the Corporation and its Inspector General. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Williams, Adley & Company, LLP

January 6, 2005
Washington, DC

This page intentionally left blank



WILLIAMS, ADLEY & COMPANY, LLP

Management Consultants
Certified Public Accountants

**INDEPENDENT AUDITORS' REPORT ON
COMPLIANCE WITH LAWS AND REGULATIONS**

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

We have audited the Statement of Financial Position of the Millennium Challenge Corporation (Corporation) as of September 30, 2004, and the related Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources for the nine months ended September 30, 2004, and have issued our report thereon dated January 6, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The Corporation's management is responsible for complying with laws and regulations applicable to the Corporation. As part of obtaining reasonable assurance that the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the Corporation.

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

The results of our tests disclosed one instance, see the Auditors' Report on Internal Control over Financial Reporting, where the agency's financial management systems did not substantially comply with the Federal financial management systems requirements. This instance of non-compliance is required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02

Providing an opinion on compliance with those provisions was not, however, an objective of our audit and, accordingly, we do not express such an opinion.

This audit was performed pursuant to the Government Corporation Control Act, and is intended solely for the information and use of the United States Congress, the President, the Director of the Office of Management and Budget, the Comptroller General of the United States, the Corporation and its Inspector General. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Williams, Adley & Company, LLP

January 6, 2005
Washington, DC

**Management
Comments and
Our Evaluation**

We consider the management comments to be responsive to the recommendations made in this report. We have included these comments in their entirety in Appendix I.

MCC's management noted the non-compliance and internal control weakness identified in the auditors' reports and concurred with the report finding and recommendation that MCC require the National Business Center (NBC) to conduct an internal control review to assess the control environment of the Oracle Federal Financials System used to process MCC's transactions. MCC stated that it has discussed the issue with the NBC and NBC has scheduled a SAS 70 audit of the Oracle Federal Financials System which is expected to be completed in fiscal year 2005.

Based on MCC's comments, we consider that a management decision has been reached on the report's recommendation. MCC should report to the OIG when final action has been taken.

This page intentionally left blank

