



# Millennium Challenge Corporation

Reducing Poverty Through Growth

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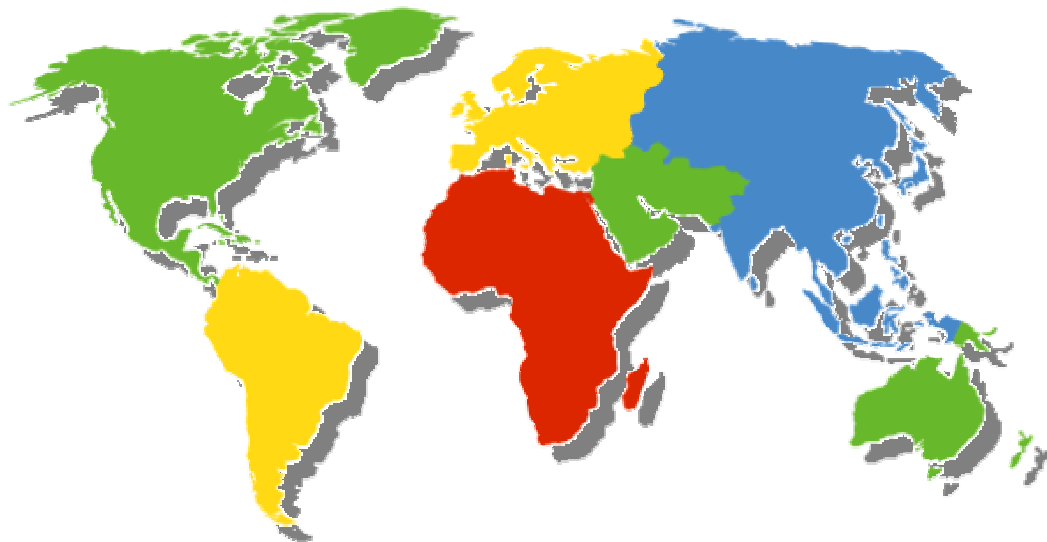
## OFFICE OF INSPECTOR GENERAL

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### **Audit of the Millennium Challenge Corporation's Efforts to Establish Its Internal Control Structure**

**Report No. M-000-05-002-P**

**March 31, 2005**



**Washington, D.C.**





# Millennium Challenge Corporation

Reducing Poverty Through Growth

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## *Office of Inspector General*

March 31, 2005

### **MEMORANDUM**

**FOR:** Acting Vice President for Administration and Finance,  
Millennium Challenge Corporation, Jonathan O. Bloom

**FROM:** Assistant Inspector General for the Millennium Challenge  
Corporation, Henry L. Barrett /s/

**SUBJECT:** Audit of the Millennium Challenge Corporation's Efforts to  
Establish Its Internal Control Structure (Report No. M-000-05-  
002-P)

This is our final report on the subject audit. In finalizing the report, we considered your written comments on our draft report and included those comments in their entirety in Appendix II of this report.

The report contains two recommendations for corrective action. Based on your response to our draft report, we consider that a management decision has been reached on each recommendation. Final action for the recommendations must be determined by MCC, and we ask that we be notified of MCC's actions.

I appreciate the cooperation and courtesy extended to my staff throughout the audit.

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## Summary of Results

The Assistant Inspector General for the Millennium Challenge Corporation conducted this audit to determine if the Millennium Challenge Corporation (MCC) implemented a system of internal controls consistent with the requirements of the Federal Managers' Financial Integrity Act and Office of Management and Budget guidance. The audit found that MCC had not fully implemented a system of internal controls consistent with the guidance (see page 6).

Although MCC had established a number of individual internal control procedures covering its administrative operations, it did not formalize or document its system of internal controls covering all aspects of its operations (see page 7). Additionally, MCC had not conducted an evaluation of the adequacy of its internal control system at its fiscal year end (see page 9). This report contains two recommendations to address these issues.

In its response to our draft report, MCC agreed with the recommendations and explained its plans for implementing them. Therefore, we consider that a management has been reached on each recommendation (see page 13). Management comments are included in their entirety in Appendix II (see page 17).

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## Background

Internal controls are a major part of managing an organization and comprise the organization's plans, policies, and procedures used to meet its mission, goals and objectives. Broadly speaking, internal controls include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. They are used to provide reasonable assurance that (1) programs achieve their intended results, (2) resources are used consistent with the organization's mission, (3) programs and resources are protected from fraud, waste and mismanagement, (4) laws and regulations are followed, and (5) reliable and timely information is obtained, maintained, reported and used for decision making.

The importance of internal controls is addressed, both explicitly and implicitly, in various laws, regulations and Federal guidance. The Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires the heads of executive agencies to annually evaluate the adequacy of the agency's internal accounting and administrative controls and report whether the controls meet Federal standards. The FMFIA's requirements are extended to government corporations by the Government Corporation Control Act which requires the head of the management of a corporation to include a statement on internal accounting and administrative systems consistent with FMFIA requirements in the corporation's annual management report to Congress.<sup>1</sup> The Office of Management and Budget

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<sup>1</sup> The Government Corporation Control Act requires corporations to submit an annual management report to the Congress not later than 180 days after the end of the government corporation's fiscal year.

(OMB) provides guidance and reporting requirements for the annual internal control evaluations.<sup>2</sup> Lastly, the U.S. Comptroller General has established standards for internal control in the Federal Government.<sup>3</sup> Within these mandates, Government organizations are expected to establish, assess, correct and report on the adequacy of their internal controls.

The Millennium Challenge Corporation (MCC) was established in January 2004 as a new government corporation to provide development assistance to eligible countries and was designed to support innovative strategies and to ensure accountability for measurable results.

This audit was conducted to evaluate MCC's efforts to establish its internal control structure.

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**Audit Objective**

The Assistant Inspector General for the Millennium Challenge Corporation (AIG/MCC) conducted this audit as a part of its fiscal year 2005 audit plan. The objective of this audit was to answer the following question:

**Has the Millennium Challenge Corporation implemented a system of internal controls consistent with the requirements of the Federal Managers' Financial Integrity Act and Office of Management and Budget guidance?**

A description of the audit's scope and methodology is contained in Appendix I.

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**Audit Findings**

Although the Millennium Challenge Corporation (MCC) had formalized certain of its internal control procedures for its administrative operations, it had not fully implemented its internal control system for both its administrative and program areas consistent with the requirements of the Federal Managers' Financial Integrity Act and Office of Management and Budget guidance.

At the time of our review, MCC had formalized eight MCC-specific administrative internal control policies covering activities such as working hours, employee benefits, use of government equipment, and government-leased vehicles. These MCC-specific policies were distributed to its staff and posted on its intranet. In areas where MCC-specific administrative procedures had not yet been developed, MCC officials stated that they were generally following

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<sup>2</sup> Office of Management and Budget, Circular A-123, *Management Accountability and Control* (Revised June 21, 1995).

<sup>3</sup> U.S. General Accounting Office, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (November 1999). The General Accounting Office (GAO) changed its name to the Government Accountability Office in 2004. The U.S. Comptroller General is the head of the GAO.



policies and procedures applicable to Federal agencies government-wide, or administrative procedures specific to other government agencies such as the Department of State and the Department of Interior. MCC plans to tailor the procedures for other government agencies, as appropriate, to reflect MCC's organizational setting and to take advantage of the flexibilities afforded MCC by its authorizing legislation.

In the program area, MCC was in the process of designing internal controls to mitigate risks. The controls are intended to ensure MCC's proposed development programs are congruent with MCC's overall objectives, funds are managed properly, procurements are undertaken in a fair, open and transparent manner, and the programs are monitored and audited regularly. MCC's controls in the program area were still in draft format or still evolving at the time of our audit and had yet to be tested in a live environment since no country compacts had been signed.

Although MCC had taken the actions indicated above to establish its internal control structure, it had not fully documented its internal control procedures nor conducted the required annual evaluation of them. Below we discuss two areas for improvement.

### **Undocumented and Informal Internal Control Procedures**

Summary: The U.S. Comptroller General's *Standards for Internal Control in the Federal Government* specify that a government organization's internal controls should be clearly documented. MCC's internal control structure was largely undocumented at the time of our audit although MCC was following extensive informal or draft procedures. MCC had not taken the time to fully document its internal control structure because it devoted most of its time and resources to establishing its operations. Without documented internal control procedures, MCC runs the risk of operating in an ineffective control environment that lends itself to an array of vulnerabilities.

The U.S. Comptroller General's *Standards for Internal Control in the Federal Government* states that internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. It further states that the documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. Additionally, all documentation and records should be properly managed and maintained.

At the time of our audit, MCC was operating its organization with minimal documented internal control procedures. Each MCC office was queried about

internal control policies and procedures covering its specific activities. Consistently, each office stated that it had established informal internal controls but had not yet documented them or that it was following policies and procedures established by other government agencies.

For example, in the administrative area, MCC's Human Resources Office had established informal procedures for its hiring and recruiting practices but had not documented them and did not have a timeframe for completing the documentation. Also, MCC's Controller's Office stated that there were a litany of informal procedures covering much of its high risk environment but they have not been documented. MCC's Controller stated he was reviewing different sources of internal control procedures to ensure that MCC adopts procedures that are in line with its operations. Further, the Information and Technology Office did not have any documented internal control procedures at the time of our audit, nor did the Chief Technology Officer (CTO) have a timeframe for documenting internal control procedures. The CTO stated that he was new to the government and was not familiar with government rules and regulations. However, after our fieldwork ended, the CTO informed us that he had set up computer security awareness procedures and plans to follow Department of State regulations for controls.

For its program area, MCC had formalized and posted to its intranet website certain procedures or guidelines but, for the most part, it was operating under draft guidelines during the period leading up to the award of its first country agreements (compacts). MCC had developed a draft outline of the formal documents that should be prepared internally and the internal review points and approval levels that MCC would follow in the process of working with countries to develop their program proposals. Internal "transaction" teams were also employed in MCC's due diligence process leading to the negotiation and award of a country compact. While MCC's controls in the program area were largely informal or in draft form at the point of our audit, MCC's initial working drafts of compact agreements evidenced that MCC was working toward agreements intended to meet MCC's principles, including maintaining accountability.

MCC had not documented its internal control system because as a newly created government corporation, MCC had committed most of its resources to establishing its operations. MCC officials stated that they lacked the additional resources needed to expend on documenting its procedures since they were still in the process of staffing up their organization. Another factor that precluded MCC from formalizing and documenting its internal control procedures was MCC's decision to research other government agencies and corporations' control procedures to determine how these other entities carried out similar functions and responsibilities in order to develop the best procedures that related to MCC's environment.

However, without formalizing and documenting its internal control procedures, MCC was not in compliance with the U.S. Comptroller General standards for internal controls and did not necessarily have controls in place to assure itself that transactions, responsibilities and other significant events were properly executed and carried out as intended.

Documenting MCC's internal control procedures should help ensure that management's directives and goals are carried out, funds are managed properly, assets are safeguarded and programs achieve their intended results. MCC needs to develop an approach for identifying and documenting both its administrative and program controls and develop appropriate timelines for completing all phases of the work. Therefore, we are making the following recommendation:

**Recommendation No. 1: We recommend that the Millennium Challenge Corporation formalize and document its internal control system covering its administrative and program operations. The Millennium Challenge Corporation should establish a timeline for completing this activity.**

#### **Evaluation of Internal Control System Not Performed**

Summary: The Government Corporation Control Act (Act) requires government corporations to report on the adequacy of their internal control systems annually. While the Act and Office of Management and Budget (OMB) guidance do not state the "as of" date for such evaluations, OMB officials told us that the evaluation should be made as of the end of a corporation's fiscal year. MCC did not evaluate its internal controls as of the end of its first fiscal year, because it was not clear on when the evaluation needed to be done and because it was busy establishing other aspects of its operations. As a result of not conducting an evaluation of its internal controls as of its fiscal year end, MCC was not in compliance with applicable regulations, and, as well, at the time of our audit, had not yet thoroughly evaluated the adequacy of its control systems.

The Government Corporation Control Act requires government corporations to submit an annual management report to Congress not later than 180 days after the end of the corporation's fiscal year. The management report is required to include, among other things, a statement on internal accounting and administrative control systems consistent with the requirements of the Federal

Managers' Financial Integrity Act (FMFIA). The FMFIA requires each executive agency (as opposed to a government corporation) to annually report its evaluation of its internal controls by December 31. OMB guidance<sup>4</sup> similarly states that executive agencies are required to evaluate their internal controls annually and report by December 31. The OMB guidance also notes the requirement of the Government Corporation Control Act for a government corporation to include a statement on its internal controls in its annual management report to Congress. None of the above cited guidance specifies the "as of" date for the internal control evaluations although Federal agencies use a fiscal year end date for their evaluations.

We asked OMB for clarification on the "as date" for a government corporation's annual evaluation of its internal controls. According to an OMB official, the evaluation of MCC's internal controls should have been conducted at the end of the corporation's fiscal year end (September 30) and been an evaluation of the controls in place at that time. They stated that government corporations have the option of reporting on their controls in a separate report due December 31, like most Federal executive agencies, or the evaluation can be included in the annual management report due not later than 180 days after the end of the corporation's fiscal year. However, regardless of the reporting date that a government corporation chooses, the evaluation of the controls should be as of its fiscal year end.

MCC officials acknowledged that they had not evaluated their internal controls as of September 30, but noted that the applicable guidance is not clear on when the evaluation should be done and that MCC is not required to report on its internal controls until it submits its annual management report on March 31. They stated that they planned to meet the March 31 reporting date. Further, they stated that as of September 30 there would have been no high risk areas to report since MCC had only been in operation for approximately nine months and no agreements for country assistance had been reached.

As a result of its misperception of the applicable "as of" date for conducting an evaluation and because MCC was busy with other aspects of establishing its organization, MCC had not evaluated its internal controls at the end of its first year (fiscal year 2004). And, as of the time of our audit, it still had not formally evaluated its internal control system to assess whether it is properly designed to control MCC's operations and programs and to mitigate significant risks.

While MCC should get back on the regular evaluation cycle at the end of fiscal year 2005, we believe that it would make more sense for MCC to meet the fiscal

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<sup>4</sup> Office of Management and Budget Circular A-123 *Management Accountability and Control* (Revised June 21, 1995).

year 2004 reporting requirement on its internal controls by evaluating its controls as they presently exist. Therefore, we are making the following recommendation.

**Recommendation No. 2 - We recommend that the Millennium Challenge Corporation conduct an evaluation of its internal control system consistent with the requirements of the Federal Managers' Financial Integrity Act and Office of Management and Budget implementing guidance.**

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**Evaluation of  
Management  
Comments**

MCC provided written comments to our draft report that are included in their entirety in Appendix II. In its response, MCC agreed with the two recommendations in the draft report.

For Recommendation No. 1, MCC plans to institute internal control procedures for areas that it considers critical to its operations and/or have a material impact on its financial statements. In its program area, MCC identified the compact development as a critical area. MCC plans to establish internal controls in this area through awarding the compact. However, MCC also needs to consider post compact award activities such as monitoring and evaluation of the compact activities critical and institute internal controls to mitigate risks in this area. In addition, MCC still needs to establish a timeline for formalizing and documenting its internal controls.

For Recommendation No. 2, MCC plans to perform a formal review of its internal controls in fiscal year 2005 consistent with the Federal Managers' Financial Integrity Act and report on the review by November 15, 2005.

We agree with MCC's planned actions and therefore consider that a management decision has been reached on Recommendations Nos. 1 and 2.

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**Scope and  
Methodology****Scope**

The Assistant Inspector General for the Millennium Challenge Corporation conducted this audit in accordance with generally accepted government auditing standards to determine if the Millennium Challenge Corporation implemented a system of internal controls consistent with requirements outlined in the Federal Managers' Financial Integrity Act and Office of Management and Budget guidance. This audit was conducted to evaluate the efforts MCC had taken to establish its internal control structure. We did not attempt to assess the adequacy or the effectiveness of MCC's internal controls. The audit was conducted at MCC headquarters in Arlington, Virginia from November 17, 2004, to January 14, 2005.

**Methodology**

In order to gain an understanding of MCC's efforts to establish its internal control structure, we held discussions with key MCC officials. We also performed the following steps:

- Reviewed relevant laws, regulations and guidance to gain an understanding of the requirements for internal controls within the Federal government.
- Obtained an understanding of internal controls related to MCC's overall operations and the plans MCC had for designing controls in their program area.
- Reviewed MCC's internal policies and procedures covering its administrative operations.
- Reviewed MCC's organization charts.
- Relied on the work of our contracted financial statement auditors for reviewing controls covering MCC's financial activities.

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**Management  
Comments**



**Millennium Challenge Corporation**

Reducing Poverty Through Growth

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March 28, 2005

Henry L. Barrett  
Assistant Inspector General  
U.S. Agency for International Development  
AIG/MCC-Room 8.09.63, RRB  
1300 Pennsylvania Avenue, NW  
Washington, DC 20523

Re: Draft Report on the Audit of the Millennium Challenge Corporation's Efforts to  
Establish Its Internal Control Structure (Report No. M-000-05-00X-P)

Dear Mr. Barrett:

Please find herewith the Millennium Challenge Corporation's (MCC) comments on  
recommendation numbers 1 and 2 of draft report No. M-000-05-00X-P).

**Recommendation No. 1: We recommend that the Millennium Challenge Corporation formalize and document its internal control system covering its administrative and program operations. The Millennium Challenge Corporation should establish a timeline for completing this activity.**

Comments: We agree with this recommendation. MCC's plan is to institute internal control procedures for the following areas that are critical to its operations and/or have material impact on its financial statements as follows:

Human resources (hiring and recruitment practices);  
Staff Costs;  
Travel;  
Information Technology;  
Compact Development through Compact Award;  
Compliance with Laws and Regulations;  
Contract Management/Administration

**Recommendation No. 2 - We recommend that the Millennium Challenge Corporation conduct an evaluation of its internal control system consistent with the requirements of the Federal Manager's Financial Integrity Act and Office of Management and Budget implementing guidance.**

Comments: MCC expects to perform a formal FMFIA review in FY 2005 and submit a report by November 15, 2005. This assessment is expected to evaluate, amongst other factors, the areas identified above.

Sincerely,

/s/

Jonathan O. Bloom  
Senior Advisor

