OFFICE OF INSPECTOR GENERAL
For the Millennium Challenge Corporation

AUDIT OF THE MILLENNIUM CHALLENGE CORPORATION'S FINANCIAL STATEMENTS, INTERNAL CONTROLS, AND COMPLIANCE FOR THE PERIOD ENDING SEPTEMBER 30, 2011 AND 2010

AUDIT REPORT NO. M-000-12-001-C
November 15, 2011

WASHINGTON, DC

Office of Inspector General
for the Millennium Challenge Corporation

November 15, 2011

Mr. Daniel Yohannes
Chief Executive Officer
Millennium Challenge Corporation
875 15th Street, NW
Washington, DC 20005-2203

Subject: Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2011 and 2010

Dear Mr. Yohannes,

Enclosed is Williams, Adley & Company-DC, LLP's final report on the subject audit. The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of Williams, Adley & Company-DC, LLP to audit the financial statements of the Millennium Challenge Corporation (MCC) for the period ending September 30, 2011. The contract required that the audit be performed in accordance with United States Generally Accepted Government Auditing Standards, Office of Management and Budget (OMB) Bulletin 07-04 as amended, Audit Requirements for Federal Financial Statements, and the GAO/PCIE Financial Audit Manual.

The Independent Auditors expressed an unqualified opinion on MCC's FY 2011 Financial Statements. The report stated that the financial statements referred to above present fairly, in all material respects, the net position of MCC as of September 30, 2011, and its net cost, changes in net position and budgetary resources for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America. MCC's financial statements as of September 30, 2010 were audited by other auditors.

In its audit of MCC's fiscal year 2011 financial statements the auditors' identified two issues that were considered material weaknesses and two other issues that were considered significant deficiencies. These matters are listed below and are detailed in the auditor's report.

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

Material Weaknesses

- MCC's Financial Reporting Process Needs Improvement

- MCC's Process for Calculating and Reporting Accrued Expenses, Retentions, and Advances Needs Improvement

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Significant Deficiencies

- MCA Required Documentation, Including Audit Reports, Quarterly Disbursement Requests and Compact Closure Plans Are Not Submitted, Reviewed, and/or Approved In A Timely Manner

- Reconciling Fund Balance with Treasury (USAID)

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

In carrying out its oversight responsibilities, the OIG reviewed Williams, Adley & Company-DC, LLP's audit reports and documentation. This review, as differentiated from an audit in accordance with U.S. Generally Accepted Government Auditing Standards was not intended to enable the OIG to express, and we do not express, opinions on MCC's financial statements, or internal control; or on MCC's compliance with other laws and regulations. Williams, Adley & Company-DC, LLP is responsible for the attached auditor's report, dated November 10, 2011, and the conclusions expressed in the report. However, our review disclosed no instances where Williams, Adley & Company-DC, LLP did not comply, in all material respects, with applicable standards.

To address the material weaknesses and significant deficiencies in internal controls reported by Williams, Adley & Company-DC, LLP, we are listing below the findings with fifteen (15) recommendations to MCC's management:

Material Weaknesses

MCC's Financial Reporting Process Needs Improvement

Recommendations: We recommend that MCC's Administration and Finance (A& F) Division:

1. Develop and document a financial reporting process that reduces the likelihood of errors, inconsistencies, and inaccuracies and results in efficiencies and effectiveness, consistency, and accuracy of financial data.

2. Enhance the quality control process to detect errors or improper closeout of accounts through additional check totals, training and involvement of additional A&F staff members.

MCC's Process for Calculating and Reporting Accrued Expenses, Retentions, and Advances Needs Improvement

Recommendations: We recommend that MCC:

3. Develop an appropriate MCC data store of MCA expense information as required by TR-12.

4. In the interim, perform similar data validation employed at year end for each quarter going forward.

5. Prepare a MCC developed estimate for accrued expenses based upon statistical modeling or an alternative that is based on MCC obtained data.

6. Record advances in accordance with generally accepted accounting principles.

7. Develop and implement a periodic reconciliation process for advances.

8. Develop and implement a quarterly certification for advance transactions processed by the MCAs as part of the quarterly data call submission.

9. Modify MCA audit requirements to include testing and reporting of advances transactions.

Significant Deficiencies

MCA Required Documentation, Including Audit Reports, Quarterly Disbursement Requests and Compact Closure Plans Are Not Submitted, Reviewed, and/or Approved In A Timely Manner

Recommendations: We recommend that MCC's Administration & Finance Division and Department of Compact Operations:

10. Collaborate with the OIG and provide the MCA auditors with a document discussing the issues/errors that have led to delays in processing and clearing audit plans and audit reports in a timely manner.

11. Provide comprehensive guidance to MCAs regarding the procurement of firms to perform the Fund Accountability Statement audits with a focus on timeliness and completeness of the audit deliverables and potential penalties.

12. Continue to collaborate with the OIG to improve communications regarding audit status and solutions to moving individual audits to completion on a timely basis.

13. Reiterate the program requirements that Quarterly Disbursement Requests are to be accurate and complete and submitted within the required timelines and provide them with information about issues/things that cause delays.

14. Review the current guidelines for submission of Compact Closure Plans to determine if the timeline is reasonable and realistic. In addition, the Department of Compact Operations should work closely with MCAs to develop and compile a compact closure plan and resolve any outstanding items in advance of compact closure.

Reconciling Fund Balance with Treasury (USAID)

Recommendation: We recommend that MCC's Administration and Finance Division:

15. Continue to follow USAID's progress toward elimination of cash balance differences between USAID and Treasury and timely clearing suspense account items in order to monitor MCC's risk of potential misstatements.

In finalizing the report, Williams, Adley & Company-DC, LLP evaluated MCC's response to the report and acknowledged that management decisions have been reached on all of the recommendations. Williams, Adley & Company-DC, LLP stated that MCC should provide OIG with a timeline to address the recommendations and report to the OIG when final action has been taken on the recommendations.

Subsequently, MCC provided target dates for when the final actions would be completed. Thus, OIG agrees with MCC's management decisions for all 15 recommendations. Please inform us when final action has been taken.

The OIG appreciates the cooperation and courtesies extended to our staff and to the staff of Williams, Adley during the audit. Please contact Mark Norman at (202) 216-6961, if you have any questions concerning this report.

Sincerely,

/s/
Alvin A. Brown
Assistant Inspector General
Millennium Challenge Corporation

MILLENNIUM CHALLENGE CORPORATION

FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

AND INDEPENDENT AUDITORS' REPORTS THEREON

WILLIAMS ADLEY

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Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

We have audited the accompanying Balance Sheet of the Millennium Challenge Corporation (MCC) as of September 30, 2011, and the related Statements of Net Cost, Changes in Net Position and Budgetary Resources for the fiscal year then ended (hereinafter referred to as financial statements). These financial statements are the responsibility of MCC management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of MCC as of September 30, 2010 were audited by other auditors whose qualified report dated November 15, 2010, included an explanatory paragraph that described that the process for compiling accruals was not comprehensive enough to record accruals for material amounts of current-year expenses not paid or invoiced until the subsequent period. Fiscal year 2009 expenses were understated by accrual amounts, and FY 2010 expenses were overstated by those same amounts.

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. 07-04, *Audit Requirements for Federal Financial Statements,* as amended. 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 consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also 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 net position of MCC as of September 30, 2011, and its net cost, changes in net position and budgetary resources for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

The information in the Management's Discussion and Analysis section is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

The introductory information and performance information are presented for additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 10, 2011, on our consideration of MCC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audit.

Williams, Adley & Company – DC, LLP /s/

Washington, D.C.
November 10, 2011

WILLIAMS ADLEY

Independent Auditors' Report on Internal Control

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

We have audited the Principal Statements (hereinafter referred to as the financial statements) of the Millennium Challenge Corporation (MCC) as of and for the fiscal year (FY) ended September 30, 2011, and have issued our report thereon dated November 10, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) audit guidance.

MCC's management is responsible for establishing and maintaining effective internal control. In planning and performing our audits, we considered MCC's internal control over financial reporting by obtaining an understanding of MCC's internal controls, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements but not to express an opinion on the effectiveness of MCC's internal control over financial reporting. Accordingly we do not express an opinion on the effectiveness of MCC's internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in the OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. We did not test all internal controls relevant to operating objectives broadly defined by the *Federal Managers' Financial Integrity Act of 1982* (FMFIA) such as those controls relevant to ensuring efficient operations.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies that adversely affects MCC's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of MCC's principal financial statements that is more than inconsequential will not be prevented or detected by MCC's internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

As a result of our testing, we consider the findings included in Schedule A to be material weaknesses and those in Schedule B to be a significant deficiencies. The material weaknesses noted in Schedule A were not reported as material weaknesses by MCC in their FMFIA report. We noted other non-reportable matters involving internal control and its operations that we reported to management in a separate letter.

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

This report is intended solely for the information and use of management of the Millennium Challenge Corporation and its Office of Inspector General, Office of Management and Budget, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

Williams, Adley & Company – DC, LLP /s/

Washington, D.C.
November 10, 2011

<u>Schedule A – Material Weaknesses</u>

I. MCC's Financial Reporting Process Needs Improvement

MCC's financial reporting process needs improvement. In the draft annual financial statements provided to the auditors there were errors amounting to $180 million that were identified by the auditors and reported to MCC for correction. The June 2011 financial statements included an error of $596 million that MCC found prior to our review that required the financial statements to be reissued. MCC's heavy reliance on the manual compilation of financial reports, staffing limitations and tight compilation and reporting timelines resulted in an ineffective quality assurance process and thus the errors that were found.

The quarterly and annual financial reporting process is highly manual and requires several outside entities to provide materially significant financial information on a timely basis in order to prepare MCC's internal and external reports. Currently the time required to compile the financial statements from generation of the initial trial balance from the accounting system, receipt, review and recording of outside data, and the preparation and posting of adjusting entries significantly shortens the time available for the quality assurance process needed to ensure that material errors do not occur.

A summary of the errors we found in our testing of MCC's financial reporting is as follows:

- We noted an incorrect Fund Balance with Treasury balance on the Balance Sheet at June 30, 2011 and thus the financial statements did not total correctly. MCC reported $5,681 million but later revised that amount to $6,278 million, a difference of $596 million, due to a formula error in the Excel worksheet that MCC informed us of prior to our review of those statements.

- In the original submission of the September 30, 2011 draft financial statements, on the Statements of Changes in Net Position, the total financing sources for FY 2010 was overstated by $50 million and the unexpended appropriations beginning balance as adjusted was overstated by $130 million. We reported these errors to MCC who indicated that transposition errors had occurred.

In an effort to address various issues noted in prior year audits, including challenges with financial reporting, MCC established the Financial Integrity Task Force in FY 2011 that resulted in additional training and quality control tools for the Department of Administration and Finance (A&F).

OMB Circular A-123, Management's Responsibility for Internal Control states:

> "*Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting. Reliability of financial reporting means that management can reasonably make the following assertions:*
> - *All reported transactions actually occurred during the reporting period and all assets and liabilities exist as of the reporting date (existence and occurrence);*
> - *All assets, liabilities, and transactions that should be reported have been included and no unauthorized transactions or balances are included (completeness);*

- *All assets are legally owned by the agency and all liabilities are legal obligations of the agency (rights and obligations);*
- *All assets and liabilities have been properly valued, and where applicable, all costs have been properly allocated (valuation);*
- *The financial report is presented in the proper form and any required disclosures are present (presentation and disclosure);*
- *The transactions are in compliance with applicable laws and regulations (compliance):*
- *All assets have been safeguarded against fraud and abuse; and*
- *Documentation for internal control, all transactions, and other significant events is readily available for examination."*

MCC's Financial Reporting, Financial Audits, and Agency Financial Reports Policy and Procedure Manual, section 8.1 states:

> *"Step 2: The Division of Finance, DCFO/ACFO, reviews, validates and conducts quality assurance on financial statements. If errors are found, the Division of Finance staff make necessary changes and reissue the revised financial statement package."*

MCC's unqualified opinion was obtained through "heroic efforts" because the financial reporting by MCC requires extensive time and effort from MCC personnel. MCC's heavy reliance on manual compilation of financial reports and validation of the underlying data show that improvements are needed to ensure that systems, processes, and controls routinely generate reliable, useful, and timely financial information. This manual process and tight timelines reduces the time for quality control and thus increases the likelihood of misstatement due to human error. MCC does not currently have an effective review process in place to ensure accurate financial reporting. As a result, material errors in the financial statements could mislead readers as to the financial activities of MCC.

Recommendations: We recommend that MCC A&F:

1. Develop and document a financial reporting process that reduces the likelihood of errors, inconsistencies, and inaccuracies and results in efficiencies and effectiveness, consistency, and accuracy of financial data.

2. Enhance the quality control process to detect errors or improper closeout of accounts through additional check totals, training and involvement of additional A&F staff members.

II. Controls over MCC Accrued Expenses, Retentions, and Advances Need Improvement

The controls over the accrued expenses, retentions, and advances need improvement. MCC accrued expenses and retentions related to the Millennium Challenge Accounts (MCAs) are approximately $276 million or 92% of the accounts payable recorded and reported by MCC quarterly. MCA advances are approximately $185 million or 93% of the advances reported on MCC's financial statements. These balances are reported in the financial statements based upon a quarterly data call reporting process that began at the end of the prior fiscal year.

During FY 2011 in response to prior year audit recommendations, MCC provided quarterly instructions and templates to the MCAs regarding the advances, accruals, and retentions data call reporting. However, the instructions and templates changed between the first and second quarters of FY 2011.

Issues with advances have been noted in past financial statement audits as material misstatements that required a restatement of the FY 2009 financial statements and material audit adjustments to the FY 2010 financial statements. Initially, MCC records all advance transactions in the general ledger as an expense. Using the quarterly data call reporting workaround MCC records a journal voucher to move outstanding advances from expenses to advances.

Until the fourth quarter there was no other MCC review to ensure that these material transactions were accurate. Additionally, the timelines used for the majority of the fiscal year for MCA quarterly data call submissions were tight leaving little time for reconciliation and follow-up with the MCA.

Also, during FY 2011 MCC implemented Federal Accounting Standards Advisory Board (FASAB) Technical Release (TR) 12 for estimating accruals for its grant program, i.e. Compacts. Because MCC does not have the historical data store to accurately estimate accrued expenses, MCC relied on the MCAs to act as a "proxy" to provide accurate, reliable, and complete data to produce the estimated accrued expense balances. During most of the year minimal quality assurance checks were performed on the MCA data before recording in the general ledger and quarterly financial statements. In the fourth quarter, however, the level of quality assurance performed by MCC changed and expanded significantly.

As a result of MCC's validation of prior data calls and special reports from MCA auditors, we noted that the quarterly data call reporting on which MCC was placing its reliance contained misstatements. Further, several MCAs did not have internally developed processes to ensure reliable, accurate, complete and consistent reporting to MCC. Due to the high level of audit risk, we performed on-site testing of the data call reporting for accruals, advances, and retentions at six MCAs covering the first, second, and third quarters. Although our primary focus was FY 2011, we did perform tests of the September 2010 balances given the prior year issues noted in the FY 2010 auditors' report. The results of our audit indicated errors in the data call information for advances, retentions, and accruals.

- We noted errors in the MCAs' data call reporting from the first quarter through the third quarter.
- We noted accrual errors at all six MCAs. Most errors involved work in process estimates. The errors caused misstatements ranging from $227 thousand to $10 million. Also, several accruals in each quarterly data call lacked supporting documentation or were duplicates.
- Five of six MCAs had problems in properly reporting retentions quarterly. Errors in retentions ranged from $2 thousand to $3 million. We also noted a lack of supporting documentation and inadequate controls over compliance with contract requirements related to retentions.
- We noted that advances ranging from $66 thousand to $939 thousand were not included in the data calls during the three quarters.
- We noted that two of six MCAs were not using the new Advance Payment Reporting Form (APRF) to report advances after April 1, 2011, as required. MCC implemented the

APRF to serve as a secondary check on the reasonableness of the quarterly reported advances.

Technical Release 12 requires the agency to prepare reliable and timely accrual estimates for grant programs based upon historical data stores. Because MCC is at an interim stage in its implementation of TR 12 and lacks the in-house data stores, it is relying on the data obtained from the MCAs and monitoring of this estimation process.

Through the Financial Integrity Task Force, MCC employed a multi-pronged approach to ensuring data quality that included instructions, standardized reporting, one-on-one training and consultations, frequently asked questions, quarterly regional conference calls with the MCA finance teams and fiscal agents, and on-site assistance. MCC sent key staff to conduct hands on training at selected MCAs in May 2011 and also held multi-day working sessions with MCA finance teams and fiscal agents in May and June, 2011. Because of what was learned during this period MCC expanded training efforts by working with procurement personnel, finance and fiscal agent staff through the fourth quarter.

MCC implemented more extensive quality control procedures at year end to reduce the data quality risks related to completeness, accuracy and consistency. In the 4th quarter MCC's quality control procedures included obtaining MCA data quality certifications, sampling the data call's supporting documentation for completeness and accuracy, and a review of each submission for reasonableness. Because of the herculean efforts of MCC A&F and the Department of Compact Operations (DCO) and the MCAs our testing of the MCAs' fourth quarter data call submissions resulted in a net MCC overstatement of accounts payable of $4 million and an $886 thousand understatement of advances.

Technical Release 12 also requires that the agency assess the cost benefit of the controls over the data. It is unknown however the total cost of the efforts employed by MCC to ensure the data quality of the fourth quarter submissions.

Multiple causes exist for the advances, accruals, and retentions data call errors. They include:

- Insufficient guidance early in the year for development of an accrual methodology, process, and documentation,
- Inadequate review of data call prior to submission to ensure completeness, accuracy, and timeliness,
- Inadequate retention of supporting documentation,
- Lack of engagement of MCA program personnel and other persons with knowledge of the current work status,
- Incorrect use of exchange rates,
- Lack of a standardized system of electronic recording and reporting thereby resulting in a highly manual process,
- Insufficient MCA policies and procedures to ensure completeness, accuracy, timeliness, approvals, and consistency, and

- Lack of a robust quality assurance process by MCC.

Also, for the majority of the fiscal year MCC did not have sufficient controls in place and did not request sufficient documentation from the MCAs to detect errors in data call reporting.

Statement of Federal Financial Accounting Standard Number 1, Accounting for Selected Assets and Liabilities, states:

> *"Advances are cash outlays made by a federal entity to its employees, contractors, grantees, or others to cover a part of or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires. Examples include … and cash or other assets disbursed under a contract, grant, or cooperative agreement before services or goods are provided by the contractor or grantee. "*

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

> *"Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation. Control activities may be applied in a computerized information system environment or through manual processes."*
>
> *"For an entity to run and control its operations, it must have relevant, reliable, and timely communications relating to internal as well as external events."*
>
> *"Control activities help to ensure that all transactions are completely and accurately recorded."*

FASAB TR 12 *Accrual Estimates for Grant Programs* states in paragraph .11 that "preparing reliable and timely accrual estimates for grant programs must be a joint effort between the budget, financial, and program offices at each agency. It also provides that some agencies may not be able to effectively implement the procedures because they have not yet developed the necessary data stores and/or methods for preparing grant accrual estimates and thus should use the alternatives outlined in the TR."

Paragraphs 16-21 of TR 12 relate to preparing accrual estimates for new grant programs or changes to existing grant programs. "In the absence of sufficient relevant and reliable historical data on which to base accrual estimates, agencies should prepare estimates based upon the best available data at the time the estimates are made. Estimates can be based upon historical data, modeling capabilities or informed opinion, in limited instances."

The MCA data calls were inconsistently completed with varying degrees of reliability during the fiscal year. The ability for MCC to rely on the information provided was reduced, thereby, placing its financial reporting and adjustments to accounts payable and program expenses for the accrued MCA expenses ranging from $135 million to $276 million at risk for misstatements.

During the year MCC recorded adjustments for new advances of $142 million and liquidation of FY 2010 and 2011 advances of $123 million based upon the data call information. According to MCC it is more cost beneficial to record advances as expenses first and use the MCA quarterly reporting mechanism to adjust the account balances as needed. Throughout most of FY 2011 MCC did not have sufficient quality assurance procedures related to the MCA quarterly data call to ensure completeness, accuracy, and consistency of the advance data.

The completeness and accuracy of advance amounts reported on the financial statements was a high risk because MCC was using an unreliable source as a secondary check, and relying on MCA data call information and insufficient quality assurance throughout the fiscal year. MCC's financial statements could have been misstated because of control weaknesses associated with recording and reporting advances, accruals, and retentions.

Recommendations: We recommend that MCC:

3. Develop an appropriate MCC data store of MCA expense information as required by TR 12.
4. Perform similar data validation employed at year end for each quarter going forward.
5. Prepare an MCC developed estimate for accrued expenses based upon statistical modeling or alternative that is based on MCC obtained data.
6. Record advances in accordance with generally accepted accounting principles.
7. Develop and implement a periodic reconciliation process for advances.
8. Develop and implement a quarterly certification for advance transactions processed by the MCAs as part of the quarterly data call submission.
9. Modify MCA audit requirements to include testing and reporting of advances transactions.

Schedule B – Significant Deficiencies

III. **MCA Required Documentation, Including Audit Reports, Quarterly Disbursement Requests and Compact Closure Plans Are Not Submitted, Reviewed, and/or Approved in a Timely Manner**

MCC's business is providing funding, supporting MCA activities, and reporting to others on the financial, programmatic and compliance aspects of those activities in order to reduce poverty in poor countries through economic growth. To perform these duties properly MCC requires various documentation and information from the MCAs. During the audit process we noted that audit reports, quarterly disbursement requests and compact closure plans were not always submitted, reviewed, and/or approved in compliance with MCC's own guidelines for various reasons.

Audit Reports
We reviewed the status of audit reports for the period ended December 31, 2010, which were due on March 31, 2011, to determine whether MCC complied with the audit requirements and had proper controls in place to ensure timely submission of audit reports.

Of the 17 MCA audit reports that should have been received by the OIG as of July 2011, our analysis revealed the following:

- 3 Audit Reports were received within the specified timeframe;
- 8 Audit Reports were received late; and
- 6 Audit Reports had not yet been received.

As of September 30, 2011 one draft audit report had still not been received by the Office of the Inspector General (OIG) and only seven reports had been finalized by the OIG. Therefore, approximately $68 million in project expenditures through December 31, 2010 have not been audited (no draft report issued) and final reports have not been issued for approximately $626 million in project expenditures.

A timely audit involves the timely engagement of an audit firm by the MCA, an agreed upon timeline that ensures that the deliverables are provided within the deadlines, quality deliverables from the audit firms, and timely responses from the MCA, and audit firms. MCC and the OIG have responsibilities to monitor the audit process, provide technical assistance, and hold the various organizations accountable for the timely completion of audits and resolution of findings. Because this condition was noted in previous years and in an effort to improve audit report timeliness, MCC and the OIG established monthly meetings to discuss audit status and delays. Also, MCC has also decided to move toward annual audits for more mature MCAs, which is compliant with the compact agreement, in an effort to simplify the contracting and organizational review process.

Further, audit planning documents are routinely reviewed and approved late which directly affects the timing of the MCA audits. For example, draft audit reports were due on March 31, 2011 for the period ended December 31, 2010; however, many audit planning documents were not received until February or March 2011 with an average of two months between submission and approval of planning documents by OIG. The MCA audit cannot begin until audit planning documentation is approved. MCC has instituted a variety of monitoring controls, and most delays are outside of their control, but MCC is ultimately accountable for ensuring that the funds are audited. On a positive note, for the FY 2009 expenses that had been audited MCC has experienced a less than 1% rate for sustained questioned costs.

More can be done to address the root cause of most delays, audit quality. Audit quality issues that can lead to delays include errors or incomplete audit planning documents; non-inclusion of required audit steps; and errors in the report.

Quarterly Disbursement Requests

MCAs did not submit Quarterly Disbursement Requests (QDRs) for all funds in accordance with MCC policy. According to MCC's Compact Management Policies and Procedures, Quarterly Disbursement Requests are due no later than 20 days before the beginning of the quarter (October 1^{st}, January 1^{st}, April 1^{st}, and July 1^{st}). This was previously noted as a prior year audit finding. We reviewed QDRs for all funds for a sample of 10 MCAs and noted that some MCAs were repeatedly failing to submit their QDRs by the required date. In our testwork, we noted that:

- Of the sixteen active compacts required to submit QDRs for the period July 1, 2011 to September 30, 2011, three QDRs were submitted late.
- Of the eighteen active compacts required to submit QDRs in December for the period January 1, 2011 to March 31, 2011, two were submitted late.
- QDRs for the period April 1, 2011 to June 30, 2011 were all submitted on time.

In several instances we noted that the MCAs cited for untimely QDRs may have sent in a portion of the required quarterly documentation for MCC review to ensure that it was being prepared accurately. However, the full package was not received prior to the due date.

Compact Closures

Monitoring MCAs is a key internal control for MCC to ensure the effectiveness and efficiency of operations including use of the entity's resources. One of the mechanisms employed by MCC is the review and approval of the compact closeout. The compact closure plan preparation is an extensive process that requires the time and effort of a significant number of MCA and MCC personnel to ensure its completeness and accuracy. The plan usually goes through several iterations before it is finalized.

MCC has established a standard that Compact Closure Plans (CCPs) be submitted 15 months pre-close and be finalized 12 months pre-close, which implies a three-month approval and revision period.

During our testing of five compact closures, we noted that:

- Three MCAs did not submit their CCP to MCC by the deadline established in the MCC guidance. The longest delay was 247 days past the due date.
- Similarly, according to MCC guidance CCPs should be approved 12 months prior to the compact end date. None of the five compact closure plans were approved within this timeframe. One CCP was not approved until 120 days after the compact closed.

Office of the Inspector General for the Millennium Challenge Corporation's *Guidelines for Financial Audits Contracted by the Millennium Challenge Corporation's Accountable Entities* (Revised August 3, 2007) states:

> *§1.5: "MCC standard audit provisions require that the Accountable Entity (hereafter referred to as MCA) ensures that an audit is contracted by MCA for itself at least annually in accordance with these Guidelines."*
>
> §2.3: ***"****The OIG must receive the audit report in accordance with the Compact, no later than 90 days after the first anniversary of the Entry into Force and* ***no later than 90 days*** *after the end of the audited period thereafter, or such other periods as the Parties may otherwise agree."*

MCC's Financial Management Policies and Procedures (FMPP) on Compact Management, Appendix E States: Appendix E

> *"Disbursement requests are due to MCC no later than the 10th day of the last month of each quarter. Country POCs are the process managers responsible for ensuring the appropriate approvals are received and comprehensive documentation including approvals is filed."*

Two versions of MCC's *Guidelines for Closure of Millennium Challenge Compacts* were applicable during the time of the condition:

Version 2.0., effective September 8, 2009, §5.1 states:

> *"No later than* ***15 months*** *prior to the Compact End Date the Accountable Entity will submit to MCC for approval a plan for the closure of the Program."*

The revised guidance (DCO-2011-1.1), effective May 9, 2011, §5.2.1 states:

> *"No later than* ***15 months*** *prior to the Compact End Date, the Accountable Entity will submit a draft Program Closure Plan to MCC for approval. MCC and the Accountable Entity will consult in good faith with a view to reaching agreement upon the Program Closure Plan at least* ***12 months prior*** *to the Compact End Date."*

Late receipt of audit information could negatively impact MCC's decision-making process. Audit reports containing outdated information are of limited use and do not allow MCC management to provide timely guidance to MCAs. Without timely audits of these funds, improper payments may not be detected and corrected by MCC. Additionally, neither the MCA nor MCC has established repercussions for late reports.

Untimely submission of QDRs does not provide MCC with timely financial information, including projected disbursements. If QDRs are submitted late, MCA cash flow may be impeded, or PRFs may not be processed timely or more work may be required on the part of MCC and/or NBC in order to process disbursement requests.

Untimely submission and approval of CCPs may not allow for the MCA to fully execute the agreed-upon closure activities. MCAs could close out with unresolved contracts, uncollected receivables, and outstanding questioned costs. As a result MCC is required to address the issue, collect the costs from the government or vendor, or accept the loss.

Recommendations: We recommend that MCC A&F and DCO:

10. Collaborate with the OIG and provide the MCA auditors with a document discussing the issues/errors that have led to delays in processing and clearing the audit plans and audit reports in a timely manner.
11. Provide comprehensive guidance to MCAs regarding the procurement of firms to perform the FAS audits with a focus on timeliness and completeness of the audit deliverables and potential penalties.
12. Continue to collaborate with the OIG to improve communications regarding audit status and solutions to moving individual audits to completion on a timely basis.
13. Reiterate the program requirements that QDRs are to be accurate and complete and submitted within the required timelines and provide them with information about issues/things that cause delays.
14. Review their current guidelines for submission of CCPs to determine if the timeline is reasonable and realistic. In addition, DCO should work closely with MCAs to develop and compile a compact closure plan and resolve any outstanding items in advance of compact closure.

IV. Reconciling Fund Balance with Treasury

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

The Treasury Financial Manual *Preparing FMS 224*, Paragraph 3330, states:

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

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

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

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

Recommendation: We recommend that MCC A&F:

15. Continue to follow USAID's progress toward elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC's risk of potential misstatements.

Independent Auditors' Report on Compliance

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

We have audited the Principal Statements and Required Supplementary Information (hereinafter referred to as the financial statements) of the Millennium Challenge Corporation (MCC) as of and for the years ended September 30, 2011 and 2010, and have issued our report thereon dated November 10, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) audit guidance.

The management of MCC is responsible for complying with laws, regulations, contracts, and grant agreements applicable to MCC. As part of obtaining reasonable assurance about whether MCC's financial statements are free of material misstatement, we performed tests of MCC's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the financial statements amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended, including the requirements referred to in the Federal Managers' Financial Integrity Act of 1982 (FMFIA) We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts and grant agreements applicable to MCC. 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 of compliance described in the preceding paragraph of this report disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04.

This report is intended solely for the information and use of management of the Millennium Challenge Corporation and its Office of Inspector General, Office of Management and Budget, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

Williams, Adley & Company – DC, LLP /s/

Washington, D.C.
November 10, 2011

Based upon our review of the FY 2011 Report on Internal Controls and Audit Report # M-000-011-001-C, we identified 17 recommendations related to FY 2010 and prior. These recommendations consisted of 14 related to material weaknesses and 3 related to significant deficiencies. We reviewed and assessed MCC corrective actions for each Notice of Finding and Recommendations (NFR) and have made the following determinations.

Prior Year Findings:

1. Reporting Advance Payments – Material Weakness

Recommendation: Modify the Payment Request Form (PRF) to specifically identify requests for advance payments to vendors.

Status: Closed; MCC created an Advance PRF form (APRF) to help distinguish between advance and expense payments. MCC also updated their policies and procedures to require the use of an APRF.

2. Reporting Advance Payments – Material Weakness

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

Status: Closed. Training was provided by MCC.

3. Compiling Accruals (Proper Reporting period) – Material Weakness

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

Status: Closed; MCC established a methodology for accrual reporting and distributed this methodology to MCAs in March 2011 as part of the revised data call procedures. However, there were problems and errors with the process and new recommendations were issued with the FY 2011 material weakness.

4. Compiling Accruals (Proper Reporting period) – Material Weakness

Recommendation: Establish consistent communication with NBC and the MCAs for understanding the process and methodology developed.

Status: Closed

5. Compiling Accruals (Proper Reporting period) – Material Weakness

Recommendation: Perform quality control procedures over amounts obtained and recorded. Review the amounts posted for reasonableness, accuracy, and completeness.

Status: Closed; MCC modified policies and procedures in this area; however, they were not effectively implemented. We noted a material weakness with this process in the FY 2011 internal control report.

6. Untimely Performance of MCA Audits – Material Weakness

Recommendation: Implement a process for coordinating with MCAs, audit firms, and the OIG to ensure all parties are adequately informed of the progress of all audits and to ensure that MCA audits are completed in accordance with the compact.

Status: Closed; MCC has implemented a process; however, the audits are still untimely. Additional recommendations were made in the FY 2011 significant deficiency.

7. Untimely Performance of MCA Audits - Material Weakness

Recommendation: Establish and implement a process to ensure that MCAs prepare and make available for audit the status of advances to contractors, retention balances and data necessary for MCC to properly report its accruals.

Status: Open

8. Improper and Untimely Quarterly Reporting – Material Weakness

Recommendation: Establish and implement a process to ensure that all personnel responsible for QFRs to guide them to submit accurately prepared and properly approved QFRs and Disbursement Requests in a timely manner.

Status: Closed: MCC implemented a process that has reduced the number of untimely QFRs and Disbursement Requests. However, we noted additional untimely submissions in FY 2011. See the new FY 2011 significant deficiency and recommendations in this area.

9. Improper and Untimely Quarterly Reporting - Material Weakness

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

Status: Closed

10. Inadequate Oversight of 609(g) Funded Transactions – Material Weakness

Recommendation: Coordinate with appropriate management levels to implement a formal process for administering 609(g) funds in all countries not managed by either MCC or an MCA.

Status: Closed; New policies and procedures were finalized and implemented in March 2011.

11. Inadequate Oversight of 609(g) Funded Transactions - Material Weakness

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

Status: Closed

12. Inadequate Oversight of 609(g) Funded Transactions - Material Weakness

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

Status: Open; We noted that the new CPS policies and procedures include a revised signature card. This revised signature card includes an MCC authorizing signature, effective dates, and termination dates. However, MCC has not developed a periodic review process for CPS Signature cards to ensure they are for active users only. Therefore we determine that this recommendation has been partially implemented.

13. Inadequate Processing of Closed Programs - Material Weakness

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

Status: Closed

14. Inadequate Processing of Closed Programs - Material Weakness

Recommendation: Establish guidelines for Fiscal Accountability Directors, Fiscal Agents, as well as personnel in the Division of Finance and MCC's financial services provider to make them fully aware of any restrictions to process payments made during a program or compact close-out period.

Status: Closed

15. Reconciling Fund Balance with Treasury - Significant Deficiency

Recommendation: Continue to follow USAID's progress toward elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC's risk of potential misstatements.

Status: Closed; MCC has followed USAID's progress. However, a significant deficiency has been reissued in FY 2011 because USAID continues to have challenges in this area.

16. Control over Financial Reporting - Significant Deficiency

Recommendation: Strengthen quality reviews over financial statements to validate that information presented is accurate, complete, and complies with accounting standards and reporting guidance.

Status: Closed; MCC developed and documented revised policies and procedures in this area, but they have not been effectively implemented. We noted this issue in a new material weakness and recommendations on financial reporting in the FY 2011 audit report.

17. Control over Financial Reporting - Significant Deficiency

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

Status: Closed

Management Comments and Our Evaluation

We received and evaluated MCC's management comments to the recommendations made in this report. Based upon MCC's comments, we acknowledge that management decisions have been reached on all of the recommendations. MCC should provide the Office of Inspector General with a timeline to address the recommendations and report to the Office of Inspector General when final action has been taken on the recommendations.

The following is a brief summary of MCC's management comments on the recommendations included in this report and our evaluation of those comments.

Recommendation 1 (Material Weakness 1)
MCC management concurs with this recommendation.

Auditor Evaluation:
We conclude that MCC management has adequately addressed this recommendation.

Recommendation 2 (Material Weakness 1)
MCC management concurs with this recommendation.

Auditor Evaluation:
We conclude that MCC management has adequately addressed this recommendation.

Recommendations 3 - 9 (Material Weakness 2)
MCC concurs with the conditions and recommendations, whereas MCC, in determining the appropriate handling of MCA advances, developed a methodology that records MCA disbursements as expenses and, on a quarterly basis, requests information to determine an accurate adjustment for the Advances balance presented in its financial statements. When developing this methodology, MCC evaluated several alternatives and determined that the adoption of this approach resulted in a more accurate way of compiling data used to prepare quarterly and annual financial statements.

We agree with the auditor documentation which notes that MCA information improved from the 1st to the 3rd quarters of FY2011. MCC's expanded quality control procedures significantly reduced the risks related to completeness and accuracy. The results of the fourth quarter provide the strongest evidence that the MCA submissions' completeness and accuracy were continually improved.

Auditor Evaluation:
MCC management provided one response to recommendations 3 – 9. We conclude that MCC management has adequately addressed this recommendation.

Recommendations 10 - 14 (Significant Deficiency 1)
MCC will adopt the recommendations as stated.

Auditor Evaluation:
We conclude that MCC management has adequately addressed this recommendation.

Recommendation 15 (Significant Deficiency 2)
MCC concurs with the recommendation to follow USAID's progress toward elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC's risk of potential misstatements.

Auditor Evaluation:
We conclude that MCC management has adequately addressed this recommendation.

MILLENNIUM CHALLENGE CORPORATION
UNITED STATES OF AMERICA

November 10, 2011

Mr. Alvin Brown
Assistant Inspector General
Millennium Challenge Corporation

Dear Mr. Brown:

MCC has reviewed the draft audit report received November 9, 2011. In response to audit findings characterized as material weaknesses and significant deficiencies, as well as the associated recommendations, MCC has the following comments:

Material Weakness: MCC's Financial Reporting Process Needs Improvement

Recommendations from the auditors:

1. Develop and document a financial reporting process that reduces the likelihood of errors, inconsistencies, and inaccuracies and results in efficiencies and effectiveness, consistency, and accuracy of financial data.
2. Enhance the quality control process to detect errors or improper closeout of accounts through additional check totals, training and involvement of additional A&F staff members.

Response from MCC:
MCC concurs with recommendations #1 and #2.

Material Weakness: Controls over MCC Accrued Expenses, Retentions and Advances Need Improvement

Recommendations from the auditors:

3. Develop an appropriate MCC data store of MCA expense information as required by TR-12.
4. In the interim, perform similar data validation employed at year end for each quarter going forward.
5. Prepare an MCC developed estimate for accrued expenses based upon statistical modeling or alternative that is based on MCC obtained data.
6. Record advances in accordance with general accepted accounting principles.
7. Develop and implement a periodic reconciliation process for advances.
8. Develop and implement a quarterly certification for advance transactions processed by the MCAs as part of the quarterly data call submission.
9. Modify MCA audit requirements to include testing and reporting of advances transactions.

Response from MCC:
MCC concurs with recommendations #3 - #9.

Significant Deficiency: MCA Required Documentation, Including Audit Reports, Quarterly Disbursement Requests and Compact Closure Plans Are Not Submitted, Reviewed, and/or Approved In A Timely Manner

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Recommendations from the auditors:

10. Collaborate with the OIG and provide the MCA auditors with a document discussing the issues/errors that have led to delays in processing and clearing the audit plans and audit reports in a timely manner.
11. Provide comprehensive guidance to MCAs regarding the procurement of firms to perform the FAS audits with a focus on timeliness and completeness of the audit deliverables and potential penalties.
12. Continue to collaborate with the OIG to improve communications regarding audit status and solutions to moving individual audits to completion on a timely basis.
13. Reiterate the program requirements that QDRs are to be accurate and complete and submitted within the required timelines and provide them with information about issues/things that cause delays.
14. Review their current guidelines for submission of CCPs to determine if the timeline is reasonable and realistic. In addition, DCO should work closely with MCAs to develop and compile a compact closure plan and resolve any outstanding items in advance of compact closure.

Response from MCC:
MCC concurs with recommendations #10 - #14.

Significant Deficiency: Reconciling Fund Balance with Treasury

Recommendation from the auditors:

15. Continue to follow USAID's progress toward elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC's risk of potential misstatements.

Response from MCC:
MCC concurs with recommendation #15.

MCC will be addressing each recommendation as part of a comprehensive corrective action plan beginning in the first quarter of FY 2012 with the intent to develop and implement necessary changes as soon as practicable.

Sincerely,

MILLENNIUM CHALLENGE CORPORATION

By: ___________/s/____________________
Chantale Wong
Vice President, Administration and Finance and
Chief Financial Officer
Millennium Challenge Corporation

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Financial Section

The Principal Financial Statements have been prepared to report on the financial position and the results of operations of the Millennium Challenge Corporation (MCC). The Statements have been prepared from the books and records of the Agency in accordance with formats prescribed by the Office of Management and Budget (OMB) in OMB Circular A-136, *Financial Reporting Requirements*. The statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity. The Agency has no authority to pay liabilities not covered by budgetary resources. Liquidation of such liabilities requires enactment of an appropriation. Comparative data for FY 2010 have been included. MCC is presenting the following financial statements and additional information:

Balance Sheets

Statements of Budgetary Resources

Statements of Net Cost

- Statements of Changes in Net Position
- Notes to Financial Statements
- Other Accompanying Information
- Audit Reports on the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2011 and 2010

BALANCE SHEETS

	FY 2011	FY 2010
Assets		
Intra-Governmental		
Fund Balance with Treasury *(Note 2)*	**$ 5,875,161,025**	**$ 6,554,088,712**
Advances – Federal *(Note 5)*	5,861,151	8,778,900
Total Intra-Governmental	**5,881,022,176**	**6,562,867,612**
Accounts Receivable *(Note 3)*	65,098	49,409
General Property, Plant, and Equipment *(Note 4)*	4,612,820	5,857,213
Advances – Public *(Note 5)*	192,187,111	182,343,189
Total Assets	**$ 6,077,887,205**	**$ 6,751,117,423**
Liabilities		
Intra-Governmental		
Accounts Payable – Federal *(Note 1F)*	$ 10,290,179	$ 5,055,266
Contributions and Payroll Taxes Payable	527,333	476,667
Total Intra-Governmental	**10,817,512**	**5,531,933**
Federal Employee and Veteran Benefits Payable	12,604	12,443
Accounts Payable – Public *(Note 1F)*	290,366,872	208,104,353
Accrued Funded Liabilities	8,531,046	9,279,041
Total Liabilities	**$ 309,728,034**	**$ 222,927,770**
Net Position		
Unexpended Appropriations – Other Funds	$ 5,763,269,299	$ 6,522,071,077
Cumulative Results of Operations – Other Funds	4,889,872	6,118,576
Total Net Position	**$ 5,768,159,171**	**$ 6,528,189,653**
Total Liabilities and Net Position	**$ 6,077,887,205**	**$ 6,751,117,423**

The notes are an integral part of these financial statements.

STATEMENTS OF BUDGETARY RESOURCES

	FY 2011	FY 2010
Budgetary Resources		
Unobligated Balance – Beginning of Period	$ 944,204,120	$ 787,102,593
Recoveries of Prior Years Obligations	4,152,213	4,045,794
Budget Authority:		
Appropriations *(Note 1C)*	900,000,000	1,105,000,000
Non expenditure Transfers, Net, Anticipated and Actual	0	(2,377,922)
Permanently Not Available	(1,800,000)	(50,000,000)
Total Budgetary Resources	**$ 1,846,556,333**	**$ 1,843,770,465**
Status of Budgetary Resources		
Obligations Incurred		
Direct	$ 581,848,132	$ 899,566,345
Unobligated Balance Available	671,745,269	451,137,424
Unobligated Balance Not Available	592,962,932	493,066,696
Total Status of Budgetary Resources	**$ 1,846,556,333**	**$ 1,843,770,465**
Change in Obligated Balance		
Obligated Balance, Net – as of October 1, 2010		
Unpaid Obligations, Brought Forward, October 1	$ 5,609,507,905	$ 5,868,196,304
Obligations Incurred	581,848,132	899,566,345
Gross Outlays	(1,577,749,645)	(1,154,208,950)
Recoveries of Prior Year Unpaid Obligations, Actual	(4,152,213)	(4,045,794)
Obligated Balance, Net – End of Period		
Unpaid obligations	$ 4,609,454,179	$ 5,609,507,905
Net Outlays		
Gross Outlays	$ 1,577,749,645	$ 1,154,208,950

The notes are an integral part of these financial statements.

Statements of Net Costs

Program	FY 2011	FY 2010
Program Costs *(Note 7)*		
Compact		
Gross Costs	$ 1,449,285,114	$ 1,020,176,345
Less: Earned Revenue	0	0
Net Program Costs	1,449,285,114	1,020,176,345
609 (g) Programs		
Gross Costs	28,825,091	19,551,450
Less: Earned Revenue	0	0
Net Program Costs	28,825,091	19,551,450
614 (g) Programs		
Gross Costs	50,614	0
Less: Earned Revenue	0	0
Net Program Costs	50,614	0
Threshold Programs		
Gross Costs	49,002,236	58,985,525
Less: Earned Revenue	0	0
Net Program Costs	49,002,236	58,985,525
Due Diligence Programs		
Gross Costs	37,628,706	28,555,929
Less: Earned Revenue	0	0
Net Program Costs	37,628,706	28,555,929
Audit		
Gross Costs	4,087,460	3,517,852
Less: Earned Revenue	0	0
Net Program Costs	4,087,460	3,517,852
Administrative		
Gross Costs	91,811,012	95,580,731
Less: Earned Revenue	0	0
Net Program Costs	91,811,012	95,580,731
Program Costs – Net of All Programs	**$ 1,660,690,233**	**$ 1,226,367,832**
Net Costs of Operations	**$ 1,660,690,233**	**$ 1,226,367,832**

The notes are an integral part of these financial statements.

STATEMENTS OF CHANGES IN NET POSITION

	FY 2011	FY 2010
Cumulative Results of Operations		
Beginning Balances	$ 6,118,576	$ 4,949,121
Adjustments	0	0
Beginning Balance, as Adjusted	6,118,576	4,949,121
Budgetary Financing Sources		
Appropriations Used	1,657,001,778	1,224,912,387
Other Financing Sources		
Donations and Forfeitures of Property *(Note 1P)*	236,486	269,514
Imputed Financing	2,223,265	2,355,386
Total Financing Sources	1,659,461,529	1,227,537,287
Net Cost of Operations	(1,660,690,233)	(1,226,367,832)
Net Change	(1,228,704)	1,169,455
Cumulative Results of Operations	**$ 4,889,872**	**$ 6,118,576**
Unexpended Appropriations		
Beginning Balance	$ 6,522,071,077	$ 6,694,361,386
Adjustments	0	0
Correction of errors	0	0
Beginning Balance, as Adjusted	6,522,071,077	6,694,361,386
Budgetary Financing Sources		
Appropriations Received	$ 900,000,000	$ 1,105,000,000
Appropriations Transferred In/Out	0	(2,377,922)
Other adjustments	(1,800,000)	(50,000,000)
Appropriations Used	(1,657,001,778)	(1,224,912,387)
Total Budgetary Financing Sources	(758,801,778)	(172,290,309)
Total Unexpended Appropriations	5,763,269,299	$ 6,522,071,077
Net Position	**$ 5,768,159,171**	**$ 6,528,189,653**

The notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS (AS OF SEPTEMBER 30, 2011)

Note 1—Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements have been prepared to report the financial position, results of operations and budgetary resources for MCC as required by OMB Circular A-136, *Financial Reporting Requirements*, in form and content and in accordance with Section 613 of the Millennium Challenge Act of 2003, as amended, and the Government Corporation Control Act (31 U.S.C. §9106). These financial statements have been prepared from MCC's books and records and are presented in accordance with the applicable requirements of OMB, the Secretary of the Treasury, and the Government Management and Reform Act of 1994.

MCC's accounting policies conform to and are consistent with generally accepted accounting principles (GAAP) for the Federal Government, as promulgated by OMB and prescribed by the Federal Accounting Standards Advisory Board (FASAB). The FASAB has been recognized by the American Institute of Certified Public Accountants (AICPA) as the official accounting standard setting authority for the Federal government.

MCC's principle financial statements are:

Balance Sheet;

Statement of Net Cost;

Statement of Budgetary Resources; and

Statement of Changes in Net Position.

Financial statement footnotes are also included and considered an integral part of the financial statements.

B. Reporting Entity

MCC was formed in January 2004 pursuant to the Millennium Challenge Act of 2003, as amended, (P.L. 108-199). MCC's mission is to reduce poverty by supporting sustainable economic growth in developing countries that create and maintain sound policy environments. Assistance is intended to provide economic growth and alleviate extreme poverty, strengthen good governance, encourage economic freedom, and promote investments in people.

C. Budgets and Budgetary Accounting

MCC's programs and activities are funded through no-year appropriations. Such funds are available for obligation without fiscal year limitation and remain available until expended. OMB apportions MCC program and administrative funds on an annual basis pursuant to statutory limitations in the annual appropriations bill. OMB segregates the apportionment of funds for administrative and audit oversight, compact programs, due diligence programs, 609(g) programs and threshold programs. MCC does not have any earmarked funds. Because of the no-year status of MCC appropriations, unobligated administrative, audit, and due diligence funds are not returned to the Treasury; however, unobligated balances as of September 30 for these three categories of funds are transferred to the program fund category for future obligation until expended.

D. Basis of Accounting

Financial transactions are recorded on accrual and budgetary bases in accordance with pertinent Federal accounting and financial reporting requirements. Under the accrual method of accounting, financing sources are recognized when used and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates MCC's compliance with legal constraints and controls over the use of Federal funds. The accompanying Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position are prepared on the accrual basis. The Statement of Budgetary Resources is prepared in accordance with budgetary accounting rules.

E. Fund Balance with Treasury

MCC does not maintain cash in commercial bank accounts. Rather, MCC's funds are maintained by the U.S. Treasury. The U.S. Treasury processes all cash receipts and disbursements for MCC. The fund balances with Treasury represent no-year funds, which are maintained in appropriated funds that are available to pay current and future commitments.

F. Accounts Payable

MCC records as liabilities all amounts due to others as a direct result of transactions or events that have occurred. Accounts payable represent amounts due to Federal and non-Federal entities for goods and services received by MCC, but not paid at the end of the accounting period. Accounts payable reported at the end of Fiscal Year 2011 were $290 million (non-Federal) and $10.3 million (Federal) and at the end of Fiscal Year 2010 were $208 million (non-Federal) and $5.1 million (Federal).

G. Actuarial FECA Liability

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

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

MCC incurred $3 thousand in FECA liabilities during Fiscal Year 2011 and $0 in Fiscal Year 2010.

H. Accrued Annual Leave

The value of employees' unused annual leave at the end of each fiscal quarter is accrued as a liability. At the end of each fiscal quarter, the balance in the accrued annual leave account is adjusted to reflect current pay rates and leave balances. To the extent that current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of non-vested leave are expensed when used and, in accordance with Federal requirements, no accruals are recorded for unused sick leave.

I. Net Position

Net position is composed of unexpended appropriations and cumulative results of operations. Unexpended appropriations are funds appropriated by Congress to MCC that are still available for expenditure at the end of the fiscal year. Cumulative results of operations represent the net differences between financing sources and expenses since MCC's inception.

J. Financing Sources

Per note 1C, MCC funds its program and operating expenses through no-year appropriations. Appropriations are recognized as an accrual-based financing source at the time they are used to pay program or administrative expenses, except for expenses to be funded by future appropriations.

K. Retirement Benefits

MCC's employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). FERS was established by Public Law 99-335. Pursuant to this law, most U.S. Government employees hired after December 31, 1983, are covered by FERS and Social Security. Federal employees hired prior to January 1, 1984, were allowed to elect whether they desired to participate in FERS (with Social Security coverage) or remain in CSRS. For employees covered by CSRS, MCC contributes seven percent of their gross pay toward their retirement benefits. For those employees covered by FERS, MCC contributes 11 percent of their gross pay toward retirement. Employees are also allowed to participate in the Federal Thrift Savings Plan (TSP). For employees under FERS, MCC contributes an automatic one percent of basic pay to TSP and matches employee contributions up to an additional four percent of pay, for a maximum MCC contribution amounting to five percent of pay. Employees under CSRS may participate in the TSP but will not receive either MCC's automatic or matching contributions.

Federal employee benefits costs paid by the Office of Personnel Management (OPM) and imputed by MCC are reported on the Statement of Net Cost.

L. Use of Estimates

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

During Fiscal Year 2011 the Federal Accounting Standards Advisory Board, issued Technical Release 12 (TR12) *Accrual Estimates for Grant Programs* and MCC has adopted this methodology for the recording of MCC Compact Grant Accrual Programs. TR12 provides methodologies for both mature grant programs and new grant programs where sufficient relevant and reliable historical data is not yet available. TR 12 also provides guidance on acceptable sources of documentation for grant accrual estimates, including the monitoring and validation of estimates. In the absence of sufficient relevant and reliable historical data on which to base accrual estimates, MCC prepares estimates based upon the best available data at the time the estimates are made.

M. Contingencies

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

N. Judgment Fund

Certain legal matters to which MCC can be named as a party may be administered and, in some instances, litigated and paid by other Federal agencies. In general, amounts paid in excess of $2,500 for Federal Tort Claims Act settlements or awards pertaining to these litigations are funded from a special appropriation administered by the Department of the Treasury, called the Judgment Fund. Although the ultimate disposition of any potential Judgment Fund proceedings cannot be determined, management expects that any liability or expense that might ensue would not be material to MCC's financial statements.

O. Custodial Liabilities

Under current policy and procedures, MCC disburses funds for Compact and pre-Compact projects and activities upon the presentation of a valid invoice. However, under certain conditions, MCC will fund countries by advancing funds on an as-needed basis to cover basic needs. Such funds provided to the countries are required to be deposited in interest-bearing accounts, if legally feasible, until disbursed. The interest earned on these accounts is remitted to MCC by the MCA and is then returned to the Treasury's general fund. MCC received and deposited $999 thousand and $377 thousand in interest remittances as of September 30, 2011 and 2010, respectively.

P. Donated Services

MCC may on occasion utilize donated services from other Federal agencies, individuals and private firms in the course of business operations. The approximate fair market value of donated services for Fiscal Year 2011 was $236 thousand and Fiscal Year 2010 was $270 thousand.

Q. Transfers with Other Federal Agencies

MCC is a party to allocation transfers with another Federal agency as a transferring entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays that are incurred by the child entity are charged to this allocation account, as they execute the delegated activity on behalf of the parent entity. Generally, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, apportionments are derived.

MCC allocates funds, as the parent, to USAID. In Fiscal Year 2011 and Fiscal Year 2010, MCC transferred budgetary authority to USAID of $0 and $25 million, respectively, to administer Threshold and Compact programs. USAID receives these allocations as transfers-in and reports quarterly to MCC as the child. MCC also transfers an administrative fee to USAID for the purposes of administering the Threshold and Compact programs.

Note 2—Fund Balance with Treasury

The U.S. Treasury accounts for all U.S. Government cash on an overall consolidated basis. MCC is appropriated "general" funds only and maintains theses balances in the Fund Balance with Treasury. The general fund line items on the Balance Sheet for September 30, 2011 and 2010 consisted of the amounts presented in **Exhibit 13**. The status of the general fund balances is summarized by obligated, unobligated and Non-Budgetary fund balances in **Exhibit 14**.

Exhibit 13: Fund Balance with Treasury as of September 30

	September 30, 2011 (in thousands)	September 30, 2010 (in thousands)
Fund Balances		
General Funds	$ 5,875,161	$ 6,554,089
Total	$ 5,875,161	**$ 6,554,089**

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

	September 30, 2011 (in thousands)	September 30, 2010 (in thousands)
Status of Fund Balance with Treasury		
Unobligated Balance		
Available	$ 671,745	$ 451,137
Unavailable	592,963	493,067
Obligated Balance	$ 4,609,454	$ 5,609,508
Non-Budgetary FBWT	999	377
Total	**$ 5,875,161**	**$ 6,554,089**

Note 3—Accounts Receivable, Net

Accounts receivable reflect overpayments of payroll, travel and other MCC current and former employee expenses. It also reflects substantiated disallowed MCA expenditures. MCC does not record an allowance for doubtful accounts as these expenses are deemed wholly collectible. Total receivables as of the end of Fiscal Year 2011 and Fiscal Year 2010 were approximately $65 thousand and $49 thousand, respectively.

Note 4—General Property, Plant and Equipment (PP&E), Net

MCC's PP&E costs are the associated leasehold improvements made to its leased office space as well as general equipment costs. The book value of all general PP&E for Fiscal Year 2011 and Fiscal Year 2010 was $4.6 million and $5.9 million, respectively.

MCC has made significant leasehold improvements to its office space and amortizes the improvements based on the in-service (invoice) date of the improvement. Amortization on that in-service improvement is calculated on a quarterly basis. The cost of these leasehold improvements for both Fiscal Years 2011 and 2010 was $10.9 million. Accumulated amortization was $6.4 million and $5.2 million, respectively. The useful life of the improvements is based on the lease terms: ten (10) years for the Bowen building lease and eight (8) years for the City Center building lease.

MCC's capitalization threshold for all other general property, plant and equipment is an original cost of $50,000 or more and an estimated useful life of five or more years. Accumulated depreciation was $48 thousand for Fiscal Year 2011 and $20 thousand for Fiscal Year 2010.

MCC's software capitalization threshold defines a capitalized asset that has an original cost of $200,000 or more and an estimated useful life of five years or more and the information technology (IT) infrastructure capitalization threshold defines a capitalized asset as having an original cost of $200,000 or more and an estimated useful life of three years or more. These thresholds reduce MCC's administrative costs associated with accounting for PP&E, and result in increased operational efficiency. MCC does not own its software or IT infrastructure; therefore, no depreciation has been calculated.

Note 5—Advances

Advances reflect amounts provided to compact countries and other Federal agencies in accordance with formal compacts or inter-agency agreements. Advances are liquidated and recorded as expenses upon receipt of expenditure reports from the recipients. MCC reported $198.0 million ($5.9 million Federal and $192.1 million non-federal) and $191.1 million ($8.8 million Federal and $182.3 million non-federal) in advances as of September 30, 2011 and 2010, respectively.

Note 6—Leases

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

MCC also has short term leases for 1 corporate vehicle (through June 28, 2015) and for 18 copier machines (through January 31, 2012) utilized in both buildings. The future lease payments due are depicted in **Exhibit 15** below.

Exhibit 15: Operating Leases

Future Lease Payments Due (in dollars)			
• Fiscal Year	• Bowen	• City Center	• Total

FY 2012	5,669,249	1,942,376	7,611,625
FY 2013	5,725,941	1,942,376	7,668,317
FY 2014	5,783,201	1,995,229	7,778,430
FY 2015	5,841,033	1,995,229	7,836,262
Total Future Lease Payments	**$23,019,424**	**$7,875,210**	**$30,894,634**

Future Lease Payments Due (in dollars)			
• Fiscal Year	• MCC Vehicle	• MCC Copiers	• Total
FY 2012	10,980	55,821	66,801
FY 2013	10,980		10,980
FY 2014	10,980		10,980
FY 2015	8,235		8,235
Total Future Lease Payments	**$41,175**	**$55,821**	**96,996**

Note 7—Intragovernmental Costs and Exchange Revenue

The Statement of Net Cost reports the MCC's gross cost less earned revenues to arrive at net cost of operations. Costs have been illustrated by MCC funded programs. **Exhibit 16** shows the value of exchange transactions between MCC and other Federal entities, as well as non-Federal entities. Intra-governmental costs relate to transactions between the MCC and other Federal entities. Public costs relate to transactions between the MCC and non-Federal entities. MCC does not have any exchange revenues.

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

	Program	609(g)	614(g)	Threshold	Due Diligence	Audit	Administrative	FY 2011 Total (in thousands)	FY 2010 Total (in thousands)
Intra-Governmental	4,518	3,531	0	12,681	5,153	3,871	25,135	54,889	42,228
Public	1,444,767	25,294	51	36,321	32,476	216	66,676	1,605,801	1,184,140
Total - Program	**1,449,285**	**28,825**	**51**	**49,002**	**37,629**	**4,087**	**91,811**	**1,660,690**	**1,226,368**

Note 8—Undelivered Orders at the End of the Period

Exhibit 17 presents Undelivered Orders, paid and unpaid, as of September 30, 2011 and 2010.

Exhibit 17: Undelivered Orders

Undelivered Orders	2011	2010
Administrative	$ 35,653,558	$ 28,539,653
Audit	840,492	1,031,296
609(g)	34,747,822	37,167,213
614(g)	223,767	0
Due Diligence	70,954,703	65,060,507
Program	4,297,756,596	5,334,343,971
Threshold	58,595,317	111,923,479
Total	$ 4,498,772,255	$ 5,578,066,116

Note 9— Differences between the SBR and the Budget US Government

MCC ensures that the information reported in its books is reflected within the Budget of the U.S. Government. Since MCC's financial statements are published before the President's Budget, this reconciliation is based on the Statement of Budgetary Resources column for Fiscal Year 2010 and the Fiscal Year 2010 actual data reported in the Fiscal Year 2012 budget submission. Fiscal Year 2011 actual data will be published within the 2013 Budget of the United States to be published in February 2012. No material differences were noted.

Note 10—Reconciliation of Net Cost of Operations to Budget

Exhibit 18 reconciles the resources available to MCC to finance operations with the net cost of operating MCC's programs. Some operating costs, such as depreciation, do not require direct financing sources. This exhibit illustrates the reconciliation of Net Cost of Operations to Budget for the comparative FY 2011 and FY 2010 fiscal years.

Exhibit 18: Reconciliation of Net Cost of Operations to Budget

Resources Used to Finance Activities		FY 2011 Reported Program Costs	
Budgetary Resources Obligated			
Obligations Incurred	$ 581,848,132	**Gross Costs**	$1,660,690,233
Recoveries of prior year unpaid obligations	(4,152,213)		

Other financing resources	2,459,751		
Total resources used to finance activities	580,155,670		
Total resources used to finance items not part of the net cost of operations	1,079,290,170	**Less: Earned Revenue**	-
Total components of net cost of operations that will not require or generate resources	1,244,393		
Net Cost of Operations	**$1,660,690,233**	**Net Cost of Operations**	**$1,660,690,233**

FY 2010 Resources Used to Finance Activities		**FY 2010 Program Costs**	
Budgetary Resources Obligated			
Obligations Incurred	$899,566,345	**Gross Costs**	$1,226,367,832
Recoveries of prior year unpaid obligations	(4,045,794)		
Other financing resources	2,624,899		
Total resources used to finance activities	898,145,451		
Total resources used to finance items not part of the net cost of operations	326,986,011	**Less: Earned Revenue**	-
Total components of net cost of operations that will not require or generate resources	1,236,370		
Net Cost of Operations	**$1,226,367,832**	**Net Cost of Operations**	**$1,226,367,832**

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