



2006
Annual Report

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U.S. Secretary of State Condoleezza Rice, Chair of the of MCC Board of Directors speaks at the Ghana Compact signing on August 1, 2006.



A Message from
Secretary Of State Condoleezza Rice
Chair of the Board, Millennium Challenge Corporation

Vision. Action. Results.

The goal of revolutionizing foreign development assistance to break the cycle of chronic poverty around the world inspired President Bush's bold vision for the Millennium Challenge Corporation (MCC). The President's vision has become an innovative approach to foreign aid, helping countries that have taken steps to begin governing democratically, fighting corruption, investing in health and education, opening markets, and promoting economic freedoms.

MCC is guided by the principle that transformative economic growth occurs and succeeds in reducing poverty when countries fully engage in and take responsibility for their own development. This approach is producing results in the 11 countries that have entered into compacts with MCC. From Benin, Cape Verde, Ghana, Madagascar, and Mali in Africa, to El Salvador, Honduras, and Nicaragua in Central America, to Armenia and Georgia in Eurasia, and to Vanuatu in the Pacific, these countries are pursuing a path of political, economic, and social reforms to remain eligible for MCC funding. It has also inspired other countries to enact the reforms needed to join the MCC family, producing a welcome catalyst for change.

Compact implementation is lifting communities out of poverty. Compact funds are rehabilitating roads and ports, promoting land tenure and soil conservation, improving agriculture and irrigation systems, building industrial parks, instituting micro-lending credit and business development programs, opening schools and health clinics, and upgrading water and sanitation services.

MCC and its dedicated staff are fulfilling the President's vision of poverty reduction through economic growth. I thank Congress and other U.S. Government agencies for their support of MCC's efforts. Together, we can make the vision of a better life for the world's poorest countries a reality.

Condoleezza Rice

Chair



Ambassador John Danilovich just after being sworn-in as MCC Chief Executive Officer.

A Message From
Ambassador John J. Danilovich,
Chief Executive Officer,
Millennium Challenge Corporation

In the three short years since its creation, the Millennium Challenge Corporation (MCC) has made tremendous strides in fulfilling its mission of poverty reduction through economic growth among the world's poorest countries. Our focus on three critical and interconnected priorities is making this increasing momentum possible: our organizational strength, the focus on implementation, and the contagious MCC Effect.

First, continuous improvements are streamlining the effectiveness of our operations. As an organization, we are providing our departments and our teams with greater direction, enhancements in operational processes and procedures as well as training to enable the due diligence, signing, and implementation of our compacts to occur more efficiently while improving creativity and quality. Our staff in Washington is nearing its authorized level of 300 talented professionals, who operate within a "results" culture, focusing not only on identifying issues and problems, but more importantly on providing viable solutions.

Second, our focus is not just on signing compacts but also timely compact implementation. With dedicated international development professionals recruited from the public, private, and not-for-profit sectors, MCC is prepared for and is moving ahead with compact implementation, where tangible results will improve the lives of the poor in our partner countries. We have concluded 11 compacts totaling \$3 billion with countries in Africa, Central America, Eurasia, and the Pacific, and these compacts are now at various stages of implementation. We are encouraging our partner countries to pursue their consultation processes and their capacity-building efforts to bring their multi-year compacts to fruition, and we are working to predict and mitigate implementation risks before they occur. We are incorporating lessons learned in our ongoing compact development and implementation.

Third, the incentive of MCC funding is so strong that countries continue to take it upon themselves to initiate the political, social, and economic reforms necessary to qualify for eligibility based on our performance indicators. We have seen a dramatic increase in the MCC Effect at work this year. This is a powerful validation of our approach of rewarding well-performing countries committed to governing justly, investing in their people, and promoting economic freedom. Some \$286 million has been awarded in Threshold programs to 11 countries to further reforms addressing specific policy weaknesses on our selection criteria.

The MCC has a clear, positive policy effect in countries eager to partner with us. Through the expeditious implementation of our current compacts and the development of compacts with eligible countries, we will be able to ensure a truly transformative change among the poor around the world. To accomplish this mission, we rely not only on our core values, ever-growing operational strength, and our staff expertise, but also on valuable insights from Members of Congress, fellow agencies, nongovernmental organizations, and leaders in the development field. We will continue to rely upon this feedback as we chart the course ahead toward the ongoing fulfillment of MCC's mission of poverty reduction through economic growth.

John J. Danilovich

Chief Executive Officer

MCC Board of Directors

The Millennium Challenge Corporation is managed by a Chief Executive Officer and is overseen by a public-private Board of Directors comprised of the Secretary of State, the Secretary of the Treasury, the U.S. Trade Representative, the USAID Administrator, and four individuals from the private sector appointed by the President with the advice and consent of the Senate. To date, two of these four individuals have been appointed.



Condoleezza Rice
Secretary of State
Chair



Henry M. Paulson, Jr.
Secretary of Treasury
Vice-Chair



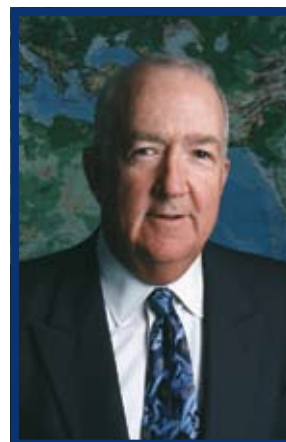
Susan C. Schwab
United States
Trade Representative



Randall Tobias
USAID Administrator



John J. Danilovich
MCC
Chief Executive Officer



Kenneth Hackett



**Christine Todd
Whitman**

Key MCC Staff

The Millennium Challenge Corporation recruits staff—diverse in knowledge, background, and talents—from other government agencies, the private sector, universities, international development agencies, non-government organizations, and the not-for-profit sector. Key staff members include:



Ambassador
John J. Danilovich
Chief Executive Officer



Rodney G. Bent
Deputy Chief Executive Officer



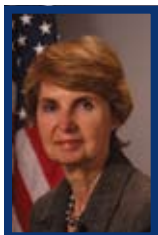
William G. Anderson, Jr.
Vice President and
General Counsel



Maureen Harrington
Vice President
Department of Policy &
International Relations



John Hewko
Vice President
Department of
Operations



Frances C. McNaught
Vice President
Department of
Congressional and
Public Affairs



Michael Ryan
Vice President
Department of
Administration
and Finance



Charles O. Sethness
Vice President
Department of
Accountability

Mission and Milestones

The Millennium Challenge Account (MCA) is an innovative foreign assistance program designed to reduce poverty through sustainable economic growth in some of the poorest countries in the world. The Millennium Challenge Corporation (MCC) is an independent U.S. Government corporation established by an act of Congress in 2004 to administer the MCA. MCA provides a strong incentive for policy reforms by offering grants to countries which have demonstrated through their policy performance their commitment to good governance.



Reducing Pov

MCC's Mission

Reducing poverty through economic growth

The mission of the Millennium Challenge Corporation is to reduce poverty by supporting sustainable, transformative economic growth in developing countries that create and maintain sound policy environments.



Pipeline repair in Georgia.

erty Through Growth



Workers transplant onion seedlings in Honduras.

MCC's Three Core Values

Reward good policy.

We partner only with those countries that measure up—and continue to measure up—to performance indicators taken from independent, non-U.S. Government sources validating that they rule justly, invest in their citizens, and support economic freedom.

Operate in partnership reinforced by “country ownership.”

We place a country in the driver's seat of its own development by expecting its participation in, ownership of, and responsibility for its development path. Therefore, we ask countries to identify and prioritize their own barriers to poverty reduction and economic growth through a broad-based consultative process involving input from civil society, including women, the private sector, and non-governmental organizations. Then, we ask that they develop their own proposal for funding and take on primary responsibility for implementing it. MCC and the partner country define how to share their respective responsibilities toward realizing the country's goals in a document referred to as a compact as well as various supplemental agreements.

Focus on results.

We hold our partner countries accountable for the aid they receive from us. Grants go to those countries that have developed well-designed programs with clear objectives, benchmarks to measure progress, procedures to ensure fiscal accountability for the funds' use, and an extensive plan for effective monitoring and objective evaluation of final outcomes and of outputs along the way. Programs are designed to enable sustainable progress even after compact funding has ended.

MCC's History

2002



March 14, 2002

March 14, 2002
President Bush proposes the creation of the Millennium Challenge Account (MCA) at the Monterrey Summit on Financing for Development, calling for a “new compact for global development” to link greater contributions from developed nations to greater responsibility from developing nations.

2004

January 23, 2004

January 23, 2004
Congress formally creates the MCA and establishes the Millennium Challenge Corporation (MCC) to administer it. With bipartisan support, Congress provides \$994 million in initial funding for Fiscal Year (FY) 2004.

February 2, 2004

February 2, 2004
MCC's Board of Directors holds its first meeting. The Board adopts the Corporation's by-laws, announces the initial 63 candidate countries, and names an interim CEO, Under Secretary of State Alan Larson.

February 27, 2004

February 27, 2004
At the earliest possible date, MCC submits criteria and methodology for selecting eligible countries for FY 2004.

May 6, 2004

May 6, 2004
After the 90 day notification period expires, MCC's Board of Directors selects 16 countries from among the 63 candidate countries to be eligible to submit proposals for FY 2004 MCA assistance.

May 5, 2004

May 5, 2004
Paul V. Applegarth is confirmed as MCC's first CEO.

June 2004
MCC staff travel to all 16 newly eligible countries to explain what MCA eligibility means, to articulate the process of compact development, and to invite them to submit a proposal.

June 2004



December 8, 2004
Congress passes the Foreign Operations Appropriations bill including \$1.488 billion for MCA funding for FY 2005.

December 8, 2004



August 26, 2004
MCC submits criteria and methodology for selecting eligible countries for FY 2005.

August 26, 2004



August 10, 2004



August 10, 2004
MCC receives the first compact proposal from Cape Verde, one of 16 countries chosen as eligible in 2004.

November 8, 2004

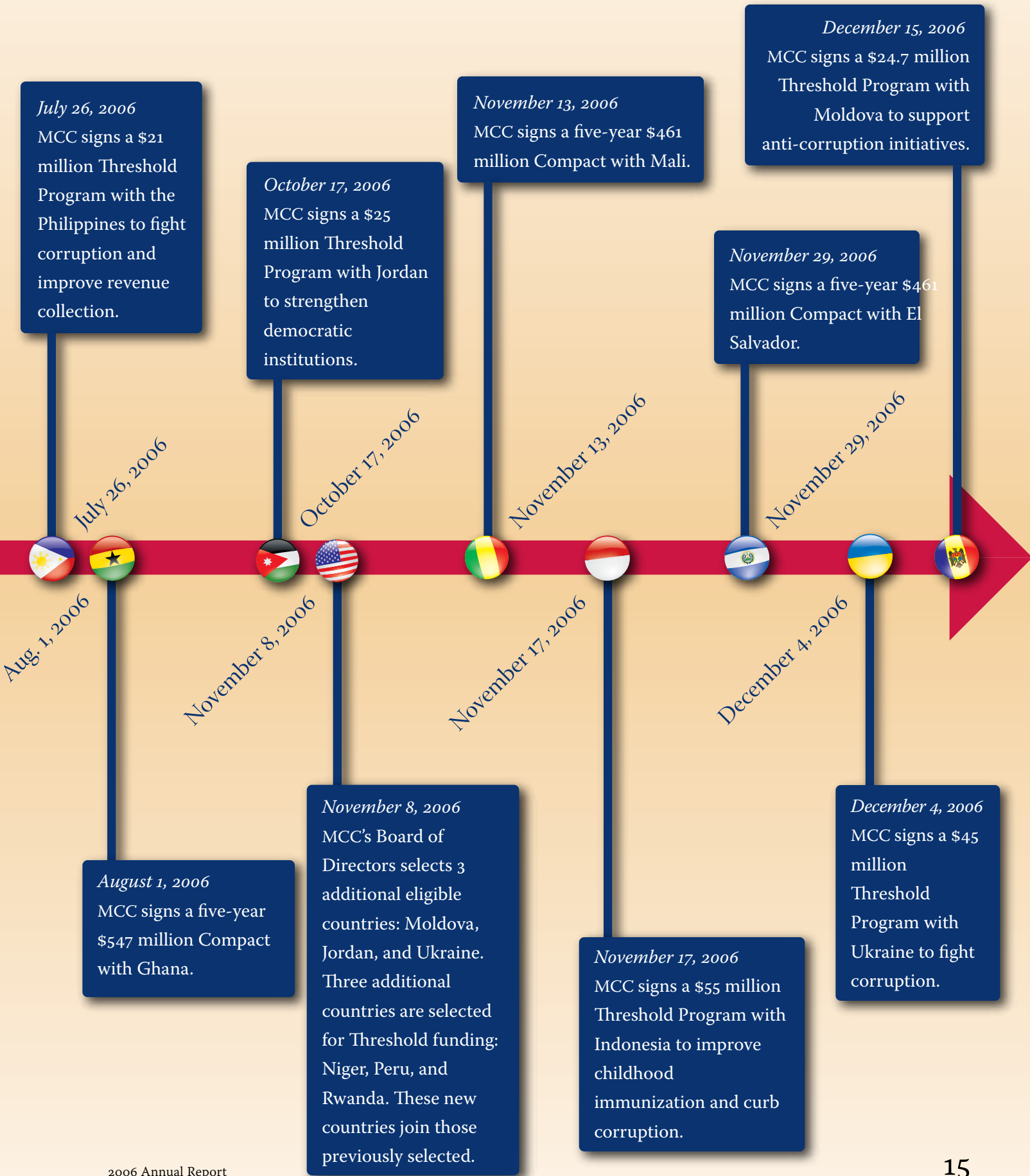


November 8, 2004
MCC's Board of Directors selects 17 countries to be eligible to submit proposals for FY 2005 MCA funds. These include the 16 countries eligible for FY 2004 funds and one new addition.









MCC's Record of Achievements: 2004-2006

In our brief history to date, MCC has developed an impressive track record of accomplishments.

Changing the way foreign aid is administered

While elements of MCC's approach have been used before, the organization incorporates the *best* lessons learned during the last half-century of work in the development field into an integrated package:

- *MCC is focused.* While most agencies have multiple mandates, MCC has a single mandate that ensures a long-term focus on reducing poverty through sustainable economic growth.
- *MCC rewards performance, not promises.* MCC works only with countries that have already shown they perform better than their peers on the policies that support growth and poverty reduction: ruling justly, investing in people, and encouraging economic freedom. By selecting countries based on transparent criteria using independent, non-U.S. Government indicators, MCC rewards countries which already have in place the policies that enable aid to be effective and thus provides an incentive for other countries to adopt sound policies.
- *MCC partners have input and take responsibility.* Programs with a broad base of in-country support are more likely to succeed. Instead of telling a country what it needs, MCC asks partner countries to determine their own development goals in consultation with civil society and the private sector and then helps them develop their own investment programs.
- *MCC insists on mutual accountability.* The partner country oversees implementation. MCC and its partner both have a stake in and a responsibility for program success. MCC monitors fiduciary responsibility.
- *MCC measures success by outcomes, not inputs.* MCC integrates measures of success and procedures to monitor and evaluate results

into the design and implementation of every compact. Failure to perform can result in reduction or loss of funding.

- *MCC assistance is an investment.* MCC conducts an investment analysis and due diligence, much as a private sector investor would, to ensure a positive return on the investment of U.S. taxpayer dollars. The key difference is that MCC does not measure monetary return, but the poverty reduction and economic growth return.
- *MCC's governance combines the best of public and private approaches.* MCC's high-level Board from the government and non-government sectors provides coherence across U.S. foreign policy, trade, finance, aid, and other policy areas critical to development, gives support and judgment to the MCC mission, and enables MCC to operate in a business-like way. MCC staff is also drawn widely from the public, private, and not-for-profit sectors. In reviewing pro-

Impact Unfolding—Compact Accomplishments

More and more results will emerge as compacts are fully implemented, but early indications of progress include:

In **Madagascar**, more than 361 land titles have been awarded, 1,800 local farmers have received technical assistance from local agricultural business centers, and 200 farmers have been trained to tap into microfinance credit thanks to MCC compact funding.

In **Nicaragua**, the property regularization component of the compact has resulted in the awarding of the first 26 “clean” titles to beneficiaries in León, many of which went to female landowners. These titles are the first of 43,000 to be delivered under the compact.

In **Georgia**, projects are underway to rehabilitate municipal water supplies in two cities that serve 230,000 Georgians and are expected to generate \$67.5 million in economic benefits to those cities. Renovating regional infrastructure will help create 24,000 new jobs and increase household incomes by almost \$60 million over the life of the compact.

posed programs, MCC consults with other federal agencies and taps the knowledge of relevant experts.

- *Congress gave MCC operational flexibility so it can do its job.* MCC grant assistance is “non-earmarked,” so MCC can respond to country priorities, and it is “no-year” so MCC is not under pressure to fund programs before they are ready and can work with eligible countries to support truly strategic, transformative programs.

Compact Accomplishments

Eleven compacts have been signed with Armenia (\$236 million), Benin (\$307 million), Cape Verde (\$110 million), El Salvador (\$461 million), Georgia (\$295 million), Ghana (\$547 million), Honduras (\$215 million), Madagascar (\$110 million), Mali (\$461 million), Nicaragua (\$175 million), and Vanuatu (\$66 million). These 4- or 5-year compacts are all designed to lift communities out of poverty. Some partner countries are using compact funding to increase agricultural productivity, or improve roads, ports and airports, or reform justice ministries, while others are using our funds to promote private land ownership, to improve access to credit, and to enable farmers to grow cash crops and get those products to market more efficiently.

Threshold Accomplishments

Threshold programs are being implemented with Albania (\$13.85 million), Burkina Faso (\$12.9 million), Indonesia (\$55 million), Jordan (\$25 million), Malawi (\$20.9 million), Moldova (\$24.7 million), Paraguay (\$34.65 million), Philippines (\$21 million), Tanzania (\$11 million), Ukraine (\$45 million), and Zambia (\$22.7 million). Most programs focus on improving governance, with an emphasis on fighting corruption. Others include education and health investments, with specific programs aimed at improving primary education rates among girls or increasing childhood immunization rates.

Global Beneficiaries

Over 22 million people living in poverty are projected to benefit directly from the programs outlined in MCC’s first 11 compacts.

Impact Unfolding— Threshold Accomplishments



Though most Threshold programs are in early stages of implementation, key successes have been noted:

Paraguay's Threshold Program, which seeks to reduce corruption and improve the business climate, met a critical goal within six months of implementation by reducing the number of days to start a business by 50 percent.

Malawi's Threshold Program, which seeks to reduce public sector corruption, spurred passage of important anti-money laundering legislation that had been lying dormant for nearly four years.

Burkina Faso's Threshold Program will improve girls' primary education completion rates. The program is supporting the construction of new "girl-friendly" schools in different areas of the country with day care centers, on-site canteens, separate male and female bathrooms, mentoring, and teacher training. Some 132 schools are on schedule to be built, complete with teachers' housing, by spring of 2007.

Albania's Threshold Program, aimed at reducing public corruption, has already seen the passage of new procurement legislation that meets European Union (EU) standards. Assistance provided under the Threshold program will help Albania use this legislation to improve procurement regulations and create a modern e-procurement system to reduce opportunities for corruption. In addition, a law creating a National Business Center to streamline business registration and remove opportunities for corruption has been drafted with broad input from the private sector, with the goal being to open the first Registration Center in 2007.

Impact Unfolding— MCC Effect



In the Dominican Republic: The Fernandez government has set up separate working groups to address the country's performance in each of the MCA categories of ruling justly, investing in people, and economic freedom. Regarding the MCA selection criteria, Presidential Technical Secretary Temistocles Montás stated, "We are embracing these goals because they are the right thing to do. They will constitute part of this administration's legacy to the Dominican people." The government of the Dominican Republic plans to release an "MCA Action Plan" and launch an MCA-Dominican Republic website to document the reforms they are adopting to become MCA eligible.

In Cameroon: Cameroon has expressed a strong interest in becoming eligible for MCA and intensified its fight against corruption. The government has removed 3,000 "ghost workers" from its payroll, referred 500 civil servants to a disciplinary council on charges of fraud or misappropriation, and promised to lift the secrecy surrounding its oil revenues. The Cameroon government has also established an MCA Inter-Ministerial Working Group and an MCA-Cameroon website to highlight the actions they are taking to come into compliance with MCA eligibility standards.

In the Philippines: In an unprecedented move, Philippine President Gloria Macapagal-Arroyo "matched" MCC's \$21 million Threshold program to fight corruption. The announcement of the MCA Threshold program appears to have given the Philippine government renewed vigor in fighting corruption. Corruption-related investigations and dismissals have stepped up significantly since the announcement of the Threshold program.

The MCC Effect

One of MCC's accomplishments and strongest measures of success early on is our role as a catalyst for policy reform, known as the *MCC Effect*. Countries want to be deemed eligible for MCC funding and are taking it upon themselves to re-evaluate their policies, regulations, and legislation related to good governance, health and education, and their business climate. Thus, MCC is creating a powerful incentive, prompting countries to enact real economic, social, and political reforms. We are motivating policy changes *before* committing any funding.

The *MCC Effect* has been well documented. According to the *Doing Business* project at the International Finance Corporation, 24 countries specifically cited the Millennium Challenge Account as the primary motivation for their efforts to improve their business environment. Inter-ministerial committees and presidential commissions have been set up in at least a dozen countries—including El Salvador, Cameroon, Djibouti, Jordan, Kyrgyz Republic, Indonesia, Guatemala, the Dominican Republic, the Philippines, Papua New Guinea, Moldova, and Ukraine—to devise reform strategies that address MCC's selection criteria.

Performance Scorecards

In MCC's short history, we have dramatically improved our incentive-based approach to development assistance through an objective evaluation of country performance to determine eligibility for funding. Country performance is published annually through scorecards made available on MCC's website. The quality and availability of vital data that we use to assess the political, social, and economic policies of countries are improving greatly and providing us with even better measures of performance.

The scorecard approach also allows MCC to act as a catalyst for policy reform and improvements. A number of trends from the latest round of data for the 2007 selection process—completed in the fall of 2006—reinforces the view that countries are indeed responding to MCC's policy measurements by making vital political, economic, and social reforms.



Impact Unfolding— Performance Scorecards

For instance:

The “Days to Start a Business” median has fallen from 41 days to 33 days for Lower Middle Income Candidate Countries. The median for Low Income Candidate Countries has fallen from 62 days in 2002 to 43 days in 2006. The International Finance Corporation estimates this magnitude of business start-up reforms inspired by MCC “can add between a quarter and a half a percentage point to growth rates in the average developing economy.”

According to the World Bank Institute, the third party indicator institution responsible for the **Control of Corruption** index, which countries must pass to meet Millennium Challenge Account (MCA) eligibility criteria, more than a dozen countries have contacted them in 2006 alone to learn about ways that they might improve their eligibility prospects. Citing MCA eligibility as an important motivation for their efforts, many countries are passing stronger anti-corruption laws, strengthening oversight institutions, opening up the public policy-making process to greater scrutiny, and stepping up corruption-related investigations and prosecutions.

MCC Engagement Worldwide

Compact Eligible Countries

At the end of 2006, 25 countries are eligible for MCA compact assistance: Armenia, Benin, Burkina Faso, Bolivia, Cape Verde, East Timor, El Salvador, Georgia, Ghana, Honduras, Jordan, Lesotho, Madagascar, Mali, Moldova, Mongolia, Morocco, Mozambique, Namibia, Nicaragua, Senegal, Sri Lanka, Tanzania, Ukraine, and Vanuatu. The MCC Board suspended The Gambia from participation in the program on June 16, 2006 due to a pattern of actions inconsistent with MCC's selection criteria.

Approved Compact Countries

Of the 25 countries eligible for compact assistance, MCC has approved 11 compacts totaling nearly \$3 billion with Madagascar, Honduras, Cape Verde, Nicaragua, Georgia, Benin, Vanuatu, Armenia, Ghana, Mali, and El Salvador. MCC is actively working toward finalizing compacts with the remaining eligible countries.

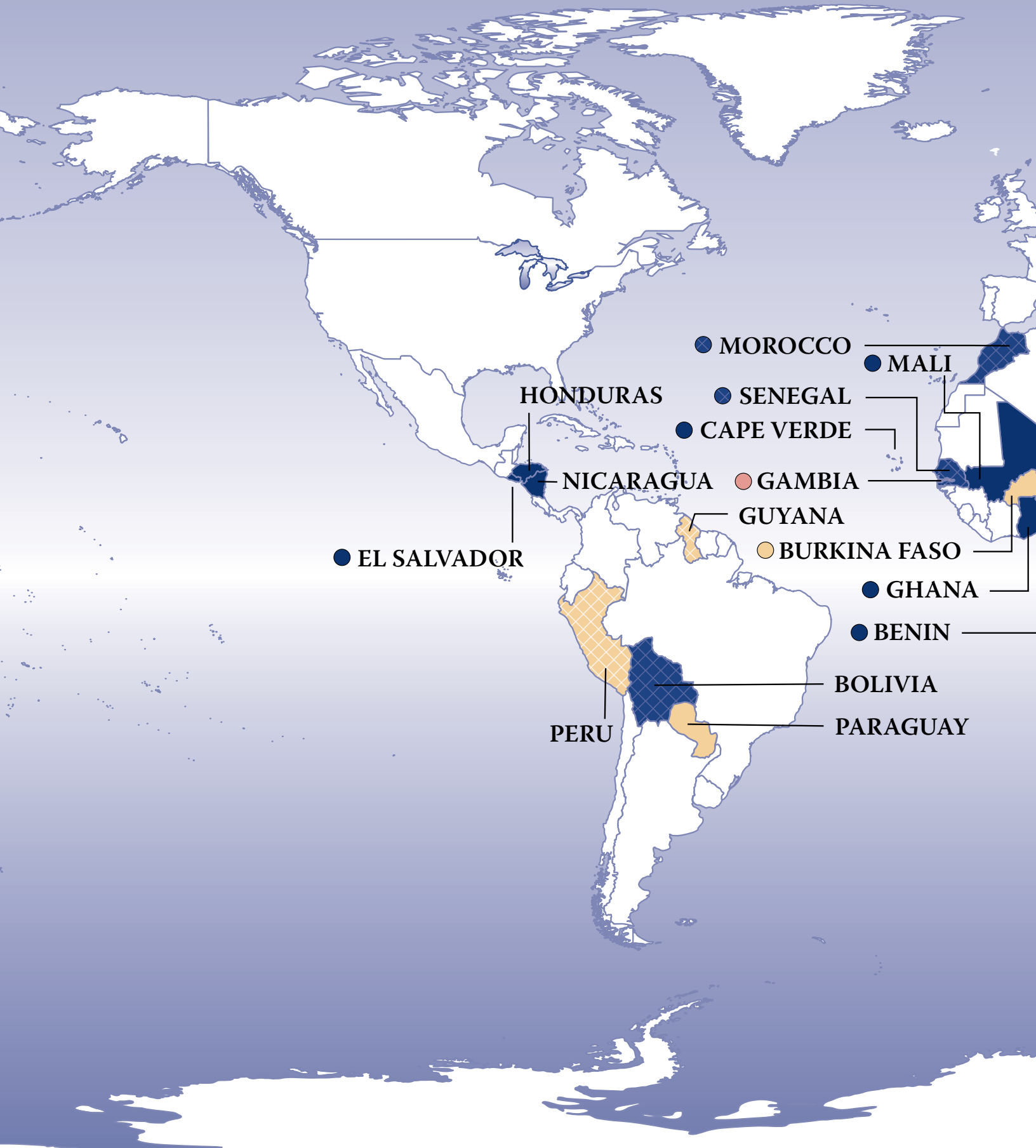
Threshold Eligible Countries

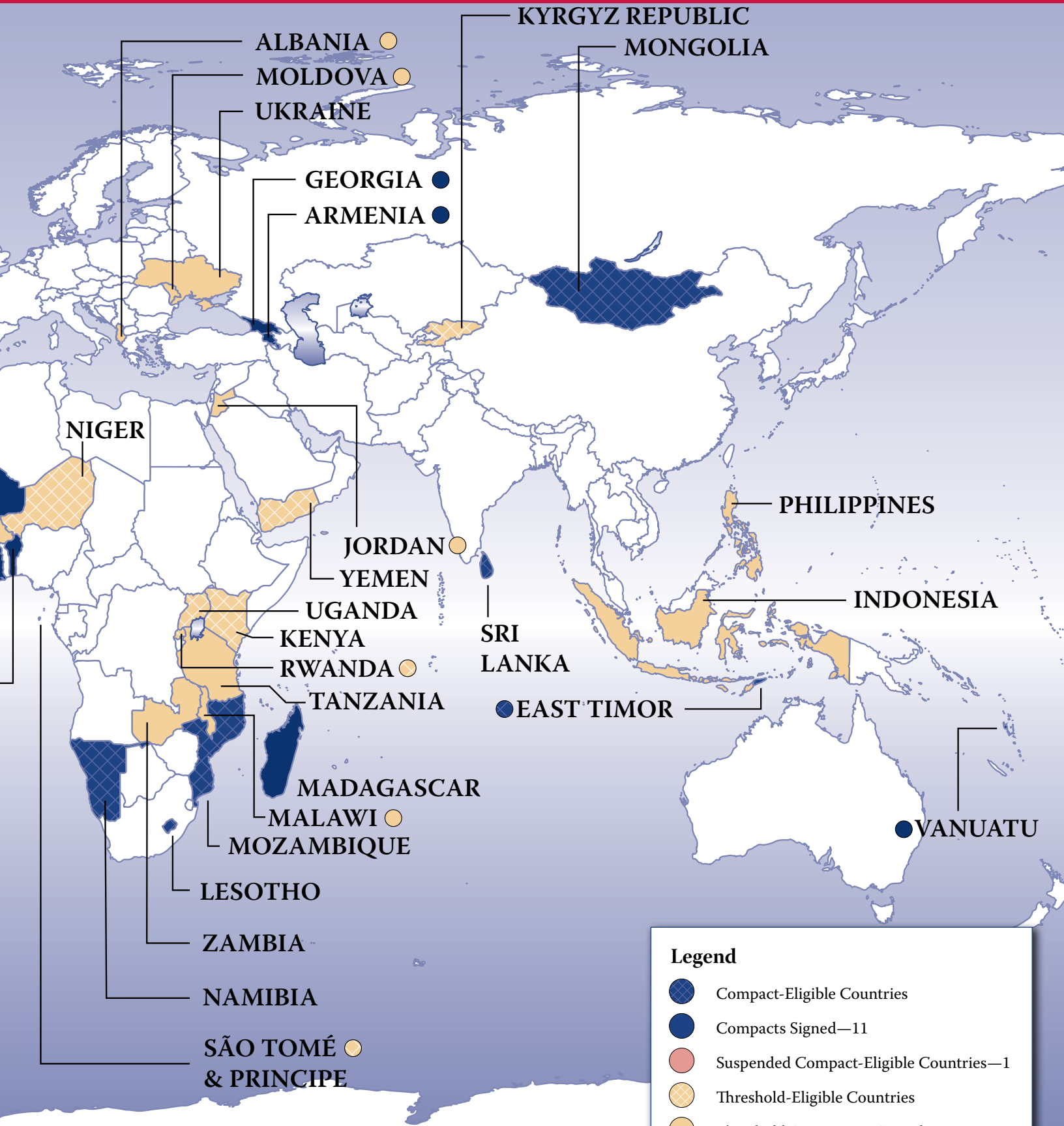
To provide further incentive for policy reform, MCC's legislation established a Threshold program for countries that demonstrate a significant commitment to meeting the eligibility criteria but fall short on several indicators. Threshold assistance helps countries address specific areas of policy weakness identified in the MCA selection indicators. The following countries are currently eligible for Threshold program assistance: Albania, Burkina Faso, East Timor, Guyana, Indonesia, Kenya, Kyrgyz Republic, Jordan, Malawi, Moldova, Niger, Paraguay, Peru, Philippines, Rwanda, Saõ Tomé and Príncipe, Tanzania, Uganda, Ukraine, and Zambia. Yemen was suspended in November 2005 from the Threshold program. Certain Threshold countries have also been selected as compact-eligible, and performance on any ongoing Threshold program will be considered by MCC's Board of Directors in approving a possible future compact.

Approved Threshold Countries

MCC has approved 11 Threshold agreements totaling over \$286 million with Burkina Faso, Malawi, Tanzania, Albania, Paraguay, Zambia, Philippines, Ukraine, Jordan, Indonesia, and Moldova.

MCC Engagement Worldwide





Legend

- Compact-Eligible Countries
- Compacts Signed—11
- Suspended Compact-Eligible Countries—1
- Threshold-Eligible Countries
- Threshold Agreements Signed—11
- Threshold Countries Suspended

The Year in Review

Overview

Under Ambassador John Danilovich's leadership, MCC in Fiscal Year (FY) 2006 worked with vision, enthusiasm, and experience to bring fresh ideas and renewed focus to creating a bolder, faster, and more results-oriented organization.

MCC graduated from a "start-up" operation to one fully engaged in maximizing organizational capacity with the right staff in place to negotiate, conclude, and sign compacts expeditiously and with a commitment to quality—meaning that, when implemented, compacts will transform the lives of the poor. We are now fully prepared and organized to tackle the more challenging implementation phase, and compact implementation joins compact development as a core competency for MCC. Monitoring, evaluation, quality control, fiscal and procurement oversight, and performance assessments are among the activities that MCC is performing to ensure the success of our compacts.

Department Highlights

Six departments, with streamlined processes, made significant strides during the past year in executing MCC's work.

- *Department of Accountability* reached full staffing levels and, as a result, formally separated Economic Analysis from Monitoring and Evaluation functions, while still preserving the close connections between the two. A new approach to Country Constraints analysis was developed, which will be used for the first time for Fiscal Year 2007 selected countries. Accountability conducted training and produced improved country guidance and new reporting formats for MCC and MCA-unit staff in such areas as environmental and social guidelines, economic and beneficiary analysis, procurement, fiscal accountability, monitoring and evaluation, impact evaluation, as well as quarterly and annual financial and results reporting. Work continued on growth and poverty impact assessments of compact components in new proposals, and commenced on designing and initiating random-

ized and other rigorous impact evaluation approaches for many of the projects beginning implementation under signed compacts.

- *Department of Administration and Finance*, responsible for managing MCC's human, financial, and information resources, took significant steps to build MCC's organizational strength in FY 2006. This involved building a mission-driven workforce that increased 86 percent as a result of an aggressive hiring plan focused on MCC's commitment to strategic diversity recruiting and outreach efforts. As a result, 63 percent of MCC's full-time employees are female or represent minority ethnic backgrounds. The Department also worked to earn MCC a clean audit opinion on our annual financial statements, even as the volume of financial obligations increased.
- *Department of Congressional and Public Affairs* further cultivated critical legislative and media relationships so as to share details of MCC's unfolding activities. Congressional and Public Affairs unveiled MCC's new logo and created important branding guidelines. The website was redesigned and improved to more effectively communicate activities, policies, and progress to partner countries as well as to the public in general. A Speakers Bureau was launched to better match interest in MCC's various topics with appropriate experts. Outreach events scheduled around Board meetings, compact signings, policy announcements, speeches, presentations, and visits from partner country officials created well-attended opportunities to discuss MCC's work. Congressional and Public Affairs continues to play a pivotal role in ensuring organizational transparency by informing all interested constituencies and stakeholders, including Members of Congress, about MCC.
- *Office of the General Counsel* is now fully staffed and the first department to implement FileSite, the electronic file management system that ultimately will be integrated organization-wide. Working in conjunction with the Department of Administration and Finance, the General Counsel's Office was instrumental in drafting and implementing key policies so that MCC improved its internal controls. To ensure greater accountability in tying funding to performance

benchmarks, the General Counsel adapted legal requirements for the disbursement of compact funds to better reflect on-the-ground realities.

- *Department of Operations*, responsible for leading compact negotiations, development, and implementation, integrated Country Programs and Markets and Sectoral Analysis into a single, coherent function to more effectively manage relationships and provide technical expertise in assessing compact proposals and overseeing implementation. The Department also developed and tested uniform standards not only for conducting due diligence on proposed projects in eligible countries but also for collecting performance reports and other related information in our partner countries. Operations' staff grew by 71 percent from 69 to 118 employees—with professionals hired and stationed in 5 partner countries—to assist with and monitor implementation of the nine total compacts signed by September 30, 2006 valued at just over \$2.0 billion.
- *Department of Policy and International Relations* made considerable strides in FY 2006 toward facilitating stronger donor coordination, improving the country selection process, expediting the Threshold program, and establishing a Private Sector Initiatives unit to manage MCC's relationships with the private sector. It helped harmonize MCC's assistance with that of other U.S. and foreign donors to magnify impact in the field. It also assessed MCC's performance on the *Paris Declaration* targets to improve overall aid effectiveness. It worked closely with third-party institutions to develop more granular, actionable, and timely policy indicators, integrate two new measures of natural resource management into MCC's country selection process, and help dozens of governments better understand the reforms needed to improve their indicator performance. Policy and International Relations also led efforts to streamline MCC's procedures for Threshold proposal development, including providing more detailed guidance.

Compacts

Four Compacts—with Armenia, Benin, Ghana, and Vanuatu—were signed in FY 2006, which join the five compacts previously signed since MCC's inception in 2004 and the two additional Compacts with Mali and El Salvador signed during the first quarter of FY 2007. Nearly \$3 billion has been committed to these 11 compacts.

Threshold Agreements

Five Threshold agreements—with Tanzania, Albania, Zambia, Paraguay, and the Philippines—were signed in FY 2006. These join the Threshold agreements concluded in previous years with Burkina Faso and Malawi, as well as those signed with Jordan, Indonesia, Moldova, and Ukraine during the first



Armenia Compact signing ceremony at the U.S. Department of State, March 27, 2006.

quarter of FY 2007. A total of \$286 million has been committed to these 11 Threshold programs.

Staffing

As of September 30, 2006, MCC had 264 full-time employees, an increase of 86 percent during FY 2006 and only 36 below MCC's planned corporate headquarters staffing level of 300. MCC used an aggressive hiring plan to keep pace with substantive organizational needs as we continue to provide funding to more countries. Because of our priority initiative and commitment to a diverse workforce, MCC increased minority hires 41 percent from June to December 2006, during which time overall staff grew by 23 percent. It is expected not only that staffing numbers will stabilize in calendar year (CY) 2007, but also that workload issues—determining what activities are kept as core competencies within MCC and what activities can be performed by outside entities, including our eligible countries—will be a key challenge in coming years. MCC continues to rely on personal service contractors, independent contractors, and innovative contract vehicles to address its mission-related personnel needs.

The MCC Effect

The *MCC Effect* is the positive impact of MCC's approach to promoting policy reform that leads to poverty reduction through growth, on strengthening countries' capacity, and on furthering development policy and practice, which is not a direct result of an MCC investment. The most significant *MCC Effect*—impact—to date is the incentive created for candidate countries to adopt legal, policy, regulatory, and institutional reforms related to MCC's selection criteria. MCC's dramatic effect on data quality and country coverage is also an important manifestation of the *MCC Effect*. In addition, the *MCC Effect* has been demonstrated by countries' experiences and lessons learned in developing and implementing their compacts. It is also evident through our innovative approach to development assistance, namely the selection of our partner countries, our approach to country ownership, and our robust monitoring and accountability frameworks.



Opposite page:
MCC staff from each of
its seven departments.



Country Selection Process

During this reporting period, MCC carried out its third cycle of selecting countries eligible to apply for compact and Threshold program assistance for FY 2006. The Millennium Challenge Act of 2003, 22 U.S.C.A. 7701, 7707 (b) (the “Act”) requires MCC to take a number of steps in determining the countries that, based on their demonstrated commitment to just and democratic governance, economic freedom, and investing in their people, will be eligible for MCA assistance during the fiscal year. Reports submitted to Congress at each of the following three stages are available on MCC’s website.

- *Stage 1: Identification of FY 2006 Candidate Countries:* In accordance with the Act, MCC submitted its Report to Congress on July 28, 2005 indicating the countries that were candidates for MCA assistance during FY 2006 based on their per capita income levels and their eligibility to receive assistance under U.S. law. This report

The 16 Indicators Used for FY 2006

Ruling Justly

1. Civil Liberties
2. Political Rights
3. Voice and Accountability
4. Government Effectiveness
5. Rule of Law
6. Control of Corruption

Encouraging Economic Freedom

1. Cost of Starting a Business
2. 1-year Consumer Price Inflation
3. Fiscal Policy
4. Trade Policy
5. Regulatory Quality
6. Days to Start a Business

Investing in People

1. Public Expenditure on Health as percent of GDP
2. Immunization Rates: DPT₃ and Measles
3. Public Primary Education Spending as percent of GDP
4. Girls’ Primary Education Completion Rate

identified 69 candidate countries in the “low income” category and 29 candidate countries in the “lower middle income” category for FY 2006.

“Low income” candidate countries have a per capita income equal to or less than \$1575. “Lower middle income” candidate countries have a per capita income between \$1575 and \$3255. MCC legislation allowed for the consideration of the new “lower middle income” countries category for the first time in FY 2006.

- *Stage 2: Selection Criteria and Methodology Report:* In accordance with the Act, MCC submitted its Report to Congress on September 6, 2005, indicating the criteria and methodology that MCC’s Board of Directors would use to measure and evaluate the candidate countries, consistent with the requirements of Section 607 of the Act, in order to select eligible countries from among them (Section 608(b) of the Act). Candidate countries compete against their income peer group on 16 policy indicators that assess the degree to which the political, social, and economic conditions in these countries promote poverty reduction and sustainable economic growth. These indicators—developed by independent, non-U.S. governmental sources—are selected based on a number of factors, including their relationship to growth and poverty reduction, transparency and country coverage, analytical rigor and objectivity, applicability across countries, and broad consistency in results from year to year.

As a general practice, MCC continually reviews the indicators used to ensure they are the best possible measures of country performance on the MCA criteria, consulting with experts across the U.S. Government, the development community, donors, and academia. For FY 2006, MCC substituted the World Bank Group’s *Cost of Starting a Business* indicator for Institutional Investor’s *Country Credit Rating* indicator. We believe there are potentially significant gains from this replacement. In addition to meeting all of MCC’s criteria for an indicator, including demonstration of a strong empirical relationship to economic growth, this additional measure of the entrepreneurial environment is easily understood by policy makers in recipient governments and is highly actionable.

Following submission of the selection criteria and methodology report to Congress and its publication on MCC's website and in the Federal Register, MCC held a 30 day public comment period on it. We also published all candidate country performance rankings sheets—or scorecards—on the website. MCC staff met with many countries to discuss their individual country performance against the indicators and highlight areas where reforms could increase future chances of qualifying for MCA funds.

- *Stage 3: MCC's Board Names FY 2006 Eligible and Threshold Countries:* The third and final step in the country selection process was the Board's determination of FY 2006 eligible countries and Threshold countries. MCC submitted this list in its Report to Congress on November 10, 2005 (Section 608(d) of the Act).

A total of 23 countries were selected as eligible to apply for MCA assistance for FY 2006. In making its selection, the Board considers whether countries perform above the median in relation to their peers on at least half of the indicators in each of the three policy categories of ruling justly, investing in people, and encouraging economic freedom as well as above the median on *control of corruption*. The Board may exercise discretion in considering additional information and adjusting for gaps, lags, or other weaknesses in the data. The Board also considers factors such as whether MCA assistance has the potential for transformational impact on poverty reduction and economic growth in a country as well as MCC resource constraints.

The selected countries from the "low income" category were: Armenia, Benin, Bolivia, Burkina Faso, East Timor, The Gambia, Georgia, Ghana, Honduras, Lesotho, Madagascar, Mali, Mongolia, Morocco, Mozambique, Nicaragua, Senegal, Sri Lanka, Tanzania, and Vanuatu. Of these 20 eligible low income countries, 16 had been selected as MCA-eligible in prior years. Burkina Faso, East Timor, The Gambia (which was later suspended), and Tanzania became MCA-eligible for the first time in FY 2006.

The MCC Board also selected three countries from FY 2006's new "lower middle income" category. These included the two new countries of El Salvador and Namibia. The third country, Cape Verde, was previously selected as MCA-eligible in the low income category.

A total of 13 countries were selected to participate in the Threshold program for FY 2006, including Guyana, Indonesia, Jordan, Kenya, Kyrgyz Republic, Malawi, Moldova, Paraguay, Philippines, São Tomé and Príncipe, Ukraine, Uganda, and Zambia.

Activities with Implications for the Future

- *New Performance Indicators:* In addition to the 16 policy indicators currently in use, two more indicators—a *Natural Resources Management Index* and a *Land Rights and Access Index*—are expected to be presented for consideration and approval by the Board of Directors in FY 2007. The identification of these indicators was a result of considerable research and consultations, which took place in FY 2006. They will provide MCC with additional measures to determine how well a country is protecting its eco-regions, providing clean drinking water, expanding sanitation services, streamlining the property registration process, and making land rights accessible and secure for poor and vulnerable populations. These are critical considerations in eradicating barriers to poverty reduction and economic growth.
- *Gender Policy:* MCC recognizes gender inequality as a significant constraint to economic growth and poverty reduction. In FY 2006, much work went toward developing, as well as planning for the public announcement of and internal training on, a formal policy statement of MCC's approach to including gender sensitivity throughout all phases of proposal and compact development and implementation.

Challenges of Measuring MCC Performance

Development of measures that show the impact of MCC programs is challenging for a number of reasons:

- While total funding for compacts is obligated up front, funding is not disbursed to the recipient country until a country is actually ready to implement the programs agreed to in the compact. For

“The MCC has shown tremendous global leadership by incorporating gender analysis that starts with project conception, consultation and program design, and follows through to all the steps of implementation and evaluation...This is the most comprehensive and practical U.S. policy on gender that I have seen.”

*—Ritu Sharma Fox,
Co-Founder and
President of the
Women's Edge
Coalition*

this reason, even initial results are not likely to occur in the year in which funding is obligated. In addition, because compacts are normally implemented over a 5-year period, outcome data is often not available until well into this implementation period. To address this, compact countries are formulating activity level monitoring plans that will enable them to report on output and process level results.

- Wherever possible, MCC uses third-party sources for outcome data in order to remove any possibility of reporting bias. However, the types of outcome measures used to determine whether programs funded through a compact are leading to economic growth and poverty reduction often rely on data that is not measured every year or for which there is a time lag. For other measures, such as the percentage of people who live on less than \$2 per day, it is difficult to establish a baseline from which to measure because data is determined by national surveys that are conducted inconsistently.
- Many of MCC's partner countries also have limited capacity to measure outcome or output results. Because countries are the primary implementers of MCC compact projects, this lack of capacity can make it more difficult to measure results within the ambitious timeframes built into MCC monitoring and evaluation plans. MCC has provided technical assistance to a number of our partner countries to help them improve their technical capacity in these areas. We are also helping them identify and track activity level indicators and incorporate them into activity monitoring plans.

We are constantly reviewing our performance metrics to look for improvements in the way we measure our outcome, output, and input performance. For example, MCC is investigating measuring economic growth and poverty reduction at a level tailored more specifically to our programs. We are also planning to develop more explicit measures in areas such as recognition and support, country partnership, and staff effectiveness and satisfaction, where an independent survey will be conducted to measure results.

Working with Other Donors

MCC has integrated donor coordination into every phase of compact development. Some MCA-funded activities have grown out of successful USAID or other donor pilot projects, while numerous others have built off of, benefited from, or otherwise leveraged the contributions of our donor partners.

- For example, MCC joined with other donors in Honduras, Nicaragua, and El Salvador to finance the construction of roads that no one donor could do alone.
- In Benin, MCC worked with the EU and the French Agency for Development to ensure proposed *Access to Justice* activities complemented and leveraged their investments in court infrastructure and procedural code development.
- MCA Madagascar's *Land Tenure Project* benefits from technical assistance provided by the French, World Bank sector work, and pilot initiatives supported by the International Fund for Agricultural Development, the Food and Agriculture Organization, and the International Land Coalition.
- As a final example, in several MCC countries, the United Nations Development Programme has helped facilitate and speed MCC compact development by funding necessary technical and proposal development expertise.

In every country where we work, MCC donor coordination efforts have helped ensure that our investments magnify development impacts and are cost-effective.

Assistance Programs: Compacts and Threshold Programs— Impact Underway

Beneficiaries in Profile

There is no more tangible way of fulfilling and measuring the success of our mission to reduce poverty through economic growth than evaluating our impact on the very lives we are transforming. The ultimate return on our efforts and investment will be felt in the lives we lift out of poverty. As our 11 current compacts mature through implementation and our 11 Threshold programs continue pushing reforms, the breadth and depth of MCC's impact will materialize. Early on, we are seeing progress and results.

MCC's compacts are designed to improve the lives of the poor by:

- Benefiting 75 percent of *Armenia's* one million-plus rural poor and increasing their annual incomes by \$36 million by 2010 by creating a more competitive agricultural sector.
- Upgrading transportation infrastructure and increasing the average per capita income of more than 65,000 of the poor in *Vanuatu* by 15 percent within 5 years.
- Increasing the annual incomes of more than 125,000 of the poor in *Cape Verde* by at least \$10 million through private sector-led growth.
- Assisting five million people, over half of *Benin's* population, and lifting an estimated 250,000 of its citizens out of poverty by the year 2015 by increasing access to land, financial services, justice, and markets.

- Impacting nearly 1.5 million people in *Georgia* and creating 7,500 new jobs, particularly in rural regions through agribusiness development.
- Supporting those living in the Leon and Chinandega regions of *Nicaragua* by significantly increasing incomes of rural farmers and entrepreneurs.
- Increasing the incomes of thousands of farmers in *Honduras*, who will transition from corn and basic grains to higher-profit crops, such as squash and jalapenos, and supporting rural improvements that will enable these farmers to reach regional and international markets.
- Transforming the lives of the poorest farmers by focusing on property rights, the financial sector, and agricultural business investment to raise annual household incomes in *Madagascar*.
- Improving the standard of living of more than 40,000 farmers and laborers in *Mali* as well as 100,000 school-aged children and their family members, who will have greater access to education, health services, and markets. More than 50,000 workers will have formal employment because of improved opportunities in manufacturing and trade.
- Alleviating directly the poverty of 230,000 individuals in *Ghana* and enhancing the livelihood and welfare of one million Ghanaians in total by raising farmer income through private-sector led agribusiness development.
- Making strategic investments in education, public services, agricultural production, rural business development, and transportation infrastructure for 850,000 poor individuals in *El Salvador* that will increase incomes by 20 percent over the five-year life of the compact and by 30 percent within 10 years of the compact's start.

Summary of Beneficiaries and Impacts Attributable to MCC Interventions

Compact Country	Project Name	Number of Beneficiaries ⁶	Compact Multi-Year Net Investment in Projects ⁷
Armenia			\$212,770,000
Compact Signed: 27 March 2006	Rural Road Rehabilitation	360,000	\$67,100,000
Entry Into Force: 2 September 2006	Irrigated Agriculture	250,000	\$145,670,000
Benin			\$259,387,000
Compact Signed: 22 February 2006	Access to Land	712,537	\$36,020,000
Entry Into Force: 06 October 2006	Access to Financial Services	216,859	\$19,650,000
	Access to Justice	2,377,312	\$34,270,000
	Access to Markets	4,031,250	\$169,447,000
Cape Verde			\$96,808,838
Compact Signed: 04 July 2005	Watershed Management & Agricultural Support	185,877	\$10,848,630
Entry Into Force: 17 October 2005	Infrastructure Project	364,074	\$78,760,208
	Private Sector Development Project	(a)	\$7,200,000
El Salvador			\$416,100,000
Compact Signed: 29 November 2006	Human Development Project	484,000	\$95,070,000
Entry Into Force: Pending	Productive Development Project	55,000	\$87,470,000
	Connectivity Project	600,000	\$233,560,000
Georgia			\$259,200,000
Compact Signed: 12 September 2005	Regional Infrastructure Rehabilitation Project	53,000	\$211,700,000
Entry Into Force: 17 April 2006	Enterprise Development Project	54,236	\$47,500,000
Ghana			\$485,376,000
Compact Signed: 01 August 2006	Agriculture Project	425,000– 654,000	\$240,984,000
Entry Into Force: Pending	Transportation Project	700,000 (b)	\$143,104,000
	Rural Development Project	30,000 (c)	\$101,288,000

Per Capita Income ⁸	MCA Country Income Indicator ⁹	Projected net Increase in Income Indicators Attributable to MCC at End of Compact ²¹
\$1,470	Change in real income from agriculture in rural areas (Index) ¹⁰	5% increase over index baseline
\$510	Average household income in land and finance areas ¹¹	Estimated at 7% increase in treated areas compared to untreated areas (difference-in-differences)
\$1,870	Increase in annual income (US\$ millions) ¹²	\$10 million increase in annual income
\$2,450	Annual per capita income of Program beneficiaries in the Northern Zone (treatment group) ¹³ Annual per capita income of Program beneficiaries in the Northern Zone (control group) ¹³	Estimated at 20.6% increase in treated areas compared to untreated areas (difference-in-differences of \$148 per capita)
\$1,350	Incremental increase in financial benefits from Compact interventions (US\$) ¹⁴	\$41,977,000 increase
\$450	Crop income (Northern Zone) (US\$ per household) ¹⁵	135% (\$945 per household) increase over baseline
	Crop income (Afram Basin Zone—East) (US\$ per household) ¹⁵	55% (\$451 per household) increase over baseline
	Crop income (Afram Basin Zone—West) (US\$ per household) ¹⁵	142% (\$767 per household) increase over baseline
	Crop income (Southern Zone) (US\$ per household) ¹⁵	33% (\$614 per household) increase over baseline

Summary of Beneficiaries and Impacts Attributable to MCC Interventions

Compact Country	Project Name	Number of Beneficiaries ⁶	Compact Multi-Year Net Investment in Projects ⁷
<i>Honduras</i>			\$197,895,000
Compact Signed: 13 June 2005 Entry Into Force: 30 September 2005	Rural Development Project	28,255 (d)	\$72,195,000
	Transportation Project	(e)	\$125,700,000
<i>Madagascar</i>			\$91,374,000
Compact Signed: 18 April 2005 Entry Into Force: 25 July 2005	Land Tenure Project	204,000 (f)	\$37,803,000
	Finance Project	125,905 (g)	\$35,888,000
	Agricultural Business Investment Project	102,000	\$17,683,000
<i>Mali</i>			\$418,506,164
Compact Signed: 13 November 2006 Entry Into Force: Pending	Bamako-Sénou Airport Improvement Project	(h)	\$89,631,177
	Industrial Park Project	3,439 (i)	\$94,266,519
	Alatona Irrigation Project	11,903 (j)	\$234,608,468
<i>Nicaragua</i>			\$153,000,000
Compact Signed: 14 July 2005 Entry Into Force: 26 May 2006	Property Regularization Project	43,000 (k)	\$26,500,000
	Transportation Project	(l)	\$92,800,000
	Rural Business Development Project	7,000 (m)	\$33,700,000
<i>Vanuatu</i>			\$60,690,000
Compact Signed: 02 March 2006 Entry Into Force: 28 April 2006	Transport Infrastructure Project	65,227	\$60,690,000

Per Capita Income ⁸	MCA Country Income Indicator ⁹	Projected net Increase in Income Indicators Attributable to MCC at End of Compact ²¹
\$1,190	Increase in income of Beneficiaries (annual US\$ millions) ¹⁶	\$69 million increase over baseline
\$290	Increase in household income in Zones ¹⁷	Estimated at 5% of average land value for each of the Zones
\$380	Total revenue of firms servicing the Airport (millions US\$) ¹⁸	13% (\$1 million) increase over baseline
	Total receipts of hotels and restaurants in Bamako (millions US\$) ¹⁸	31% (\$41 million) increase over baseline
	Gross value-added of firms in the Industrial Park (millions US\$) ¹⁸	\$33 million increase over baseline
	Real income from irrigated agricultural production (US\$ per capita) ¹⁸	\$316 per capita increase over baseline
\$910	Total Expected Income Gains (millions US\$) ¹⁹	\$20.94 million increase over baseline
\$1,600	Average cash income per capita of residents living within the catchment area of infrastructure sub-projects ²⁰	17% (\$205 per capita) increase over baseline

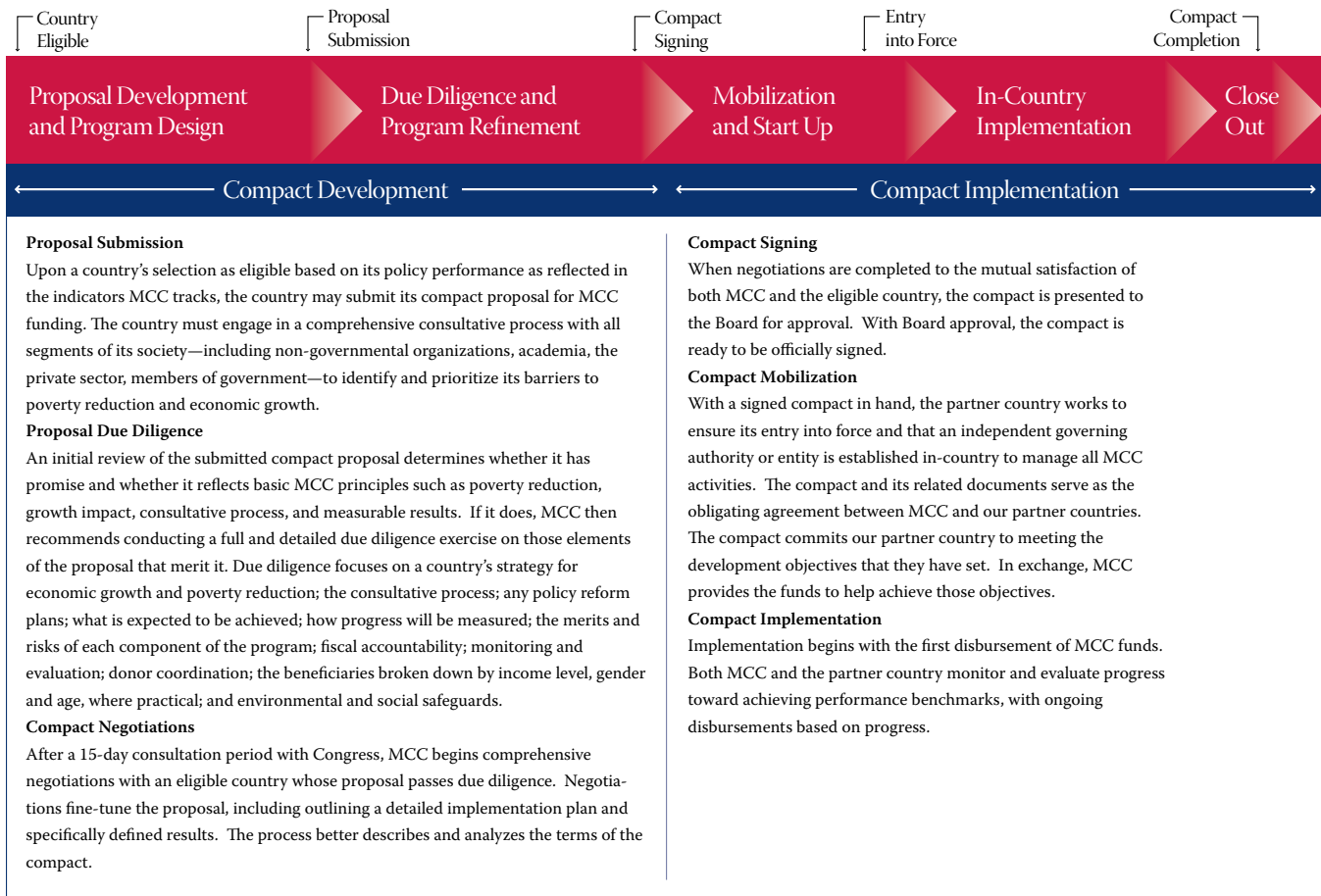
Compacts

Explaining a Compact

The word “compact” means agreement or commitment, and an MCC compact is just that. It is a mutual promise between the U.S. Government and a partner country. The U.S. Government promises to fully fund the compact and to provide assistance necessary to develop, implement, and monitor the compact. A partner country promises to implement the program it has developed to achieve its priorities for sustainable economic growth and poverty reduction according to certain performance benchmarks throughout the life of the compact. To demonstrate that the United States is committed to funding the entire four- or five-year compact and providing needed certainty for complex, multi-year programs, we obligate all of the compact money up front.

The Making of a Compact

The following chart illustrates the various stages of the MCC compact development process:





Success Story— Burkina Faso

Safoura Bagnan was recruited last year in Koutoula Yarce, one of the 132 communities receiving elementary school funding from the Millennium Challenge Corporation (MCC) in Burkina Faso. As a nine-year old, Safoura should already be in third grade. However, when she was seven, the age of enrollment in Burkina Faso, her village had no school, and her parents were reluctant to allow her to walk several kilometers to the nearest school.

In Burkina Faso fewer than half of all girls attend school. Long walking distances from schools, early and forced marriages, time-consuming household chores and lack of interest in educating girls are some of the barriers that keep thousands of girls like Safoura from going to school.

The two-year MCC project, called BRIGHT, provides incentives to remove these barriers and encourages increased enrollment and regular attendance of children in schools, particularly girls. The program is simple, but grand in its scope: to build, equip, and support 132 schools in the 10 of the 45 provinces with the lowest girls' education rates.

Three-classroom schools, boreholes for drinking water, latrines for girls and boys, and teacher housing are being constructed in remote communities that have no education infrastructure. Each school will be provided with sufficient desks to allow children to sit comfortably, free textbooks and school supplies, and a mid-day lunch program. An incentive will be provided to girls who have at least a 90% attendance rate in the form of a take home food ration worth \$4 per month. An awareness raising campaign will be organized with students' parents and community leaders during the two-year project period to fight the various obstacles that keep girls from attending school.

"Last year we had no class room. We were under temporary shelter. This year we are glad to have a brand new school. We also have desks and can sit properly. We have got notebooks and manuals for reading." —Safoura Bagnan



Safoura Bagnon



Success Story— Madagascar

Ampasimazava is a village situated on the east coast of Madagascar, where due to poor soil quality and poor agricultural infrastructure, few options existed for revenue generation. In the past, the principal economic activities of the villagers consisted of collecting firewood and producing charcoal. The average weekly revenue for a charcoal producer was less than \$5.

In October 2006, MCA-Madagascar's Agricultural Business Investment Project began working with an association of 18 villagers from Ampasimazava in producing essential oil from niaouli leaves, commonly used in cosmetic and skin care products. MCA-Madagascar assisted the association in developing a business plan, acquiring financing of \$3,000 from a local micro-finance institution to set up a distilling plant, and linking the association to buyers in the capital.

As a result of the villagers' dynamism and MCA-Madagascar's assistance, the association and its members have become successful almost overnight. Joseph, one member of the association, has managed to save \$500 within the first two months of production, and is beginning to envision his family's future in a whole new way. He began construction of a larger, cyclone-resistant house and decided to send his children to a private school that offers a better education.

The association has generated over \$1,000 of profit within the first two months of operations from member fees, which the members plan to use to make improvements to the village, including building wells to supply drinking water. They have begun to pay off their loan with the micro-finance institution, and are in the process of creating a tree nursery to begin production of eucalyptus essential oil.

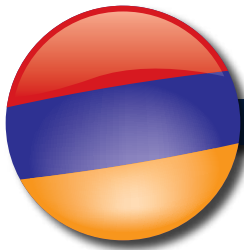


Joseph and his wife sending their children to school

Staff from the Departments of Operations and Accountability as well as the Office of the General Counsel work together on country-specific transaction teams to assist the countries in the compact development and implementation processes, to provide technical leadership to conduct due diligence, to negotiate compacts, and to maintain effective communications with partner countries.



Women process pineapples for export at a nucleus farm in Ghana.



Armenia

Key Country Facts

Population 3,016,312
 GNI Per Capita.....\$1,470

Key Compact Facts

Signed..... March 27, 2006
 Amount.....\$235.65 million
 Duration 5 years

Summary

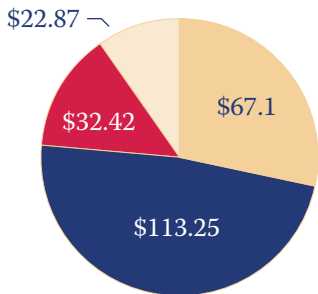
The five-year, \$235 million MCC Compact with Armenia is focused on increasing economic performance in the agricultural sector. Investments are planned to upgrade 943 kilometers of roads, providing communities and rural residents with reduced transport costs and better access to jobs, markets, and social services; and increase the productivity of 250,000 farmer households through improved water supply, higher yields, higher-value crops, and a more competitive agricultural sector.

Results underway

Several road and irrigation procurements continue to advance.

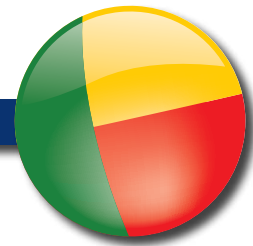
Obligations by Sector

in millions



- Program Administration & Monitoring and Evaluation
- Water-to-Market Activity
- Infrastructure Activity
- Rural Road Rehabilitation

Benin



Summary

The five-year, \$307 million MCC Compact with Benin aims to increase investment and private sector activity. The Compact is comprised of four projects: increasing access to land through more secure and useful land tenure; expanding access to financial services through grants given to micro, small, and medium enterprises; providing access to justice by bringing courts closer to rural populations; and improving access to markets by eliminating physical and procedural constraints currently hindering the flow of goods through the Port of Cotonou.

Results underway

An engineering consulting firm is in the second stage of the initial technical studies for the reconstruction of the Port of Cotonou.

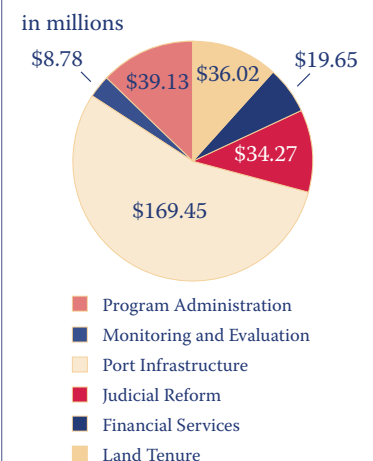
Key Country Facts

Population 8,177,208
 GNI Per Capita..... \$510

Key Compact Facts

Signed..... February 22, 2006
 Amount..... \$307.3 million
 Duration 5 years

Obligations by Sector





Cape Verde

Key Country Facts

Population 506,807
 GNI Per Capita..... \$1,870

Key Compact Facts

Signed..... July 4, 2005
 Amount.....\$110 million
 Duration 5 years

Summary

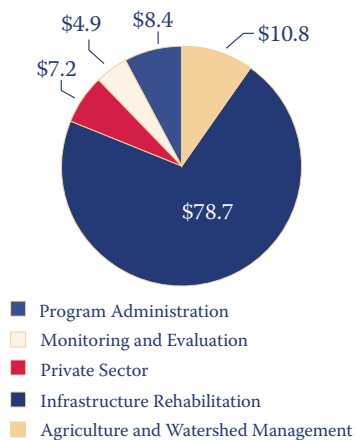
The five-year MCC Compact with Cape Verde is intended to help that country achieve its national development goal of transforming its economy from aid-dependency to sustainable, private sector-led growth. The \$110 million dollar Compact seeks to increase rural incomes of the poor by increasing agricultural productivity, integrating internal markets, reducing transportation costs, and developing the private sector through greater private sector investment and financial sector reform.

Results underway

- Infrastructure projects are underway.
- For the rehabilitation of five roads in Santiago, contracts for construction and supervision have been signed. Procurement and contracts are finished for the construction of four bridges in Santiago.
- Consultants are being selected for the expansion and modernization of the Port of Praia.

Obligations by Sector

in millions



El Salvador



Summary

In El Salvador, the five-year, \$461 million Compact seeks to improve the lives of Salvadorans through strategic investments in education, public services, agricultural production, rural business development, and transportation infrastructure. The largest of the Compact’s components, the transportation project, intends to physically unify El Salvador’s Northern Zone with the rest of the country, enabling new economic opportunities for rural households, lower transportation costs, and decreased travel times to markets for more than 850,000 beneficiaries.

Results underway

The Compact has been signed and entry into force is forthcoming. El Salvador’s Compact development process included over 2,000 Salvadorans in the consultation process whose input will continue through implementation.

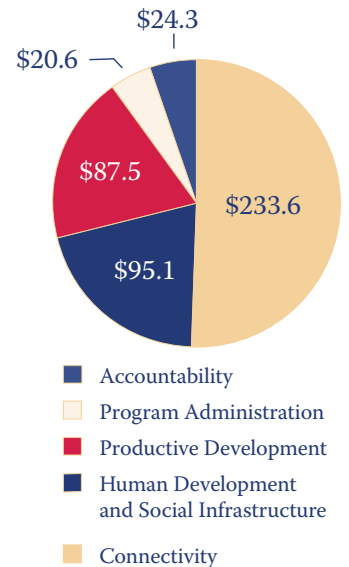
Key Country Facts

Population6,880, 951
 GNI Per Capita.....\$2,450

Key Compact Facts

Signed..... November 29, 2006
 Amount..... \$461 million
 Duration 5 years

Obligations by Sector
 in millions





Georgia

Key Country Facts

Population 4,474,404
 GNI Per Capita..... \$1350

Key Compact Facts

Signed.....September 12, 2005
 Amount..... \$295.3 million
 Duration 5 years

Summary

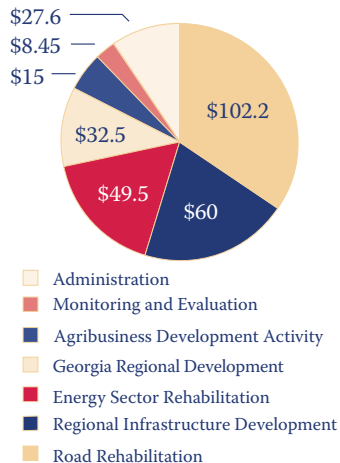
The five-year, \$295 million MCC Compact is intended to help Georgians reduce poverty by renovating key regional infrastructure and improving the development of regional enterprises. The Compact’s infrastructure projects seek to improve rural transportation, providing agricultural suppliers the opportunity to connect more easily with consumers and increase regional trade. By providing funding and technical assistance to targeted regional enterprises, the Compact aims to enhance productivity in farms, agribusinesses, and other enterprises that will increase jobs and rural income.

Results underway

- The tendering process for municipal infrastructure development has started for the rehabilitation of the water supply system in the cities of Poti and Kutaisi.
- Key contracts related to the North-South pipeline repairs have been signed and work has begun.
- The finalization of bids is imminent for the roads project, creating an essential network to revitalize regional trade.

Obligations by Sector

in millions



Ghana



Summary

The five-year, \$547 million MCC Compact aims to reduce poverty by raising farmer incomes through private sector-led, agribusiness development. Specifically, MCC investments are intended to increase the production and productivity of high-value cash and food staple crops in some of Ghana's poorest regions and to enhance the competitiveness of Ghana's agricultural products in regional and international markets.

Results underway

The Compact has been signed and entry into force is forthcoming. Key staff members for the MCA governing authority in Ghana have been recruited already.

Key Country Facts

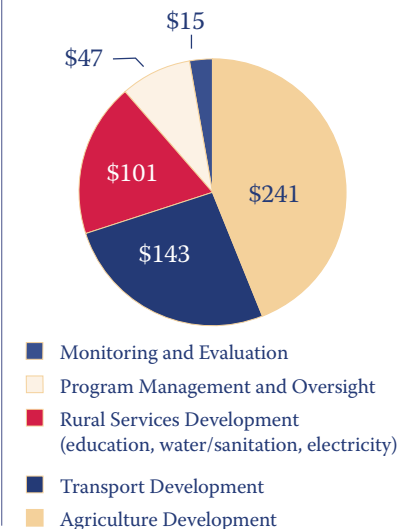
Population 22,112,800
 GNI Per Capita.....\$450

Key Compact Facts

Signed.....August 1, 2006
 Amount.....\$547.009 million
 Duration 5 years

Obligations by Sector

in millions





Honduras

Key Country Facts

Population7,204,723
 GNI Per Capita..... \$1,190

Key Compact Facts

Signed.....June 13, 2005
 Total Amount.....\$215 million
 Duration 5 years

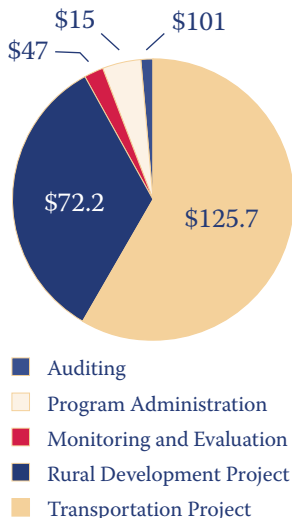
Summary

The five-year Compact with Honduras aims to reduce poverty by alleviating the two key impediments to economic growth: low agricultural productivity and high transportation costs. The \$215 million Compact places an emphasis on increasing the productivity and business skills of farmers who operate small- and medium-sized farms and their employees and reducing transportation costs between targeted production centers and national, regional, and global markets.

Results underway

- The first groups of the more than 8,000 farmers have begun receiving training in techniques for profitable production and commercialization of horticultural products.
- The Transportation Project Manager contract has been selected through an open and competitive process and has begun to prepare the bidding documents for the roads to be improved under the Transportation Project.
- As a condition precedent to disbursement, the Government of Honduras developed a comprehensive road maintenance plan that includes a commitment to increase funding for road maintenance from \$37 million in 2006 to \$45 million in 2007 and to \$64 million in 2010.

Obligations by Sector
in millions



Madagascar



Summary

The key goal of the four-year Compact with Madagascar is to help the island nation move from subsistence to a market-driven economy, particularly in agricultural production. The \$110 million Compact will support a program designed to raise incomes in rural areas by enabling better land use, expansion of the financial sector, and increased investment in farms and other rural businesses.

Results underway

- Six pilot Agricultural Business Centers (ABCs) are operational, providing technical assistance to small- and medium-sized enterprises. The ABCs have received 1,822 visitors and conducted 31 information workshops.
- The MCC-funded local land management office in Faratsiho has issued 361 land certificates as of December 31, 2006. More than 69,000 of the existing land tenure documents have been inventoried.
- Over 352 microfinance institution personnel have been trained. Some 229 farmers have been trained in accessing microfinance services.

Key Country Facts

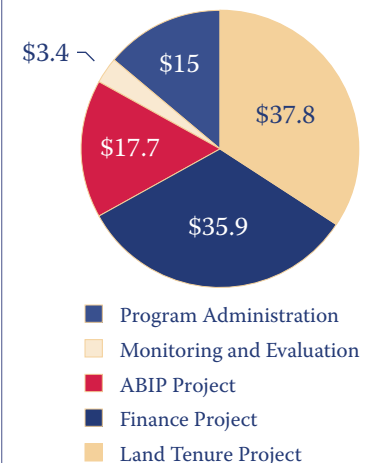
Population 18,605,920
 GNI Per Capita..... \$290

Key Compact Facts

Signed.....April 18, 2005
 Amount..... \$109.8 million
 Duration4 years

Obligations by Sector

in millions





Mali

Key Country Facts

Population 13,518,420
 GNI Per Capita.....\$380

Key Compact Facts

Signed.....November 13, 2006
 Amount..... \$460.8 million
 Duration 5 years

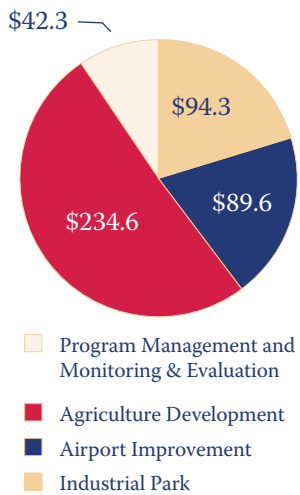
Summary

The five-year, \$461 million Compact with Mali seeks to increase the productivity of the agriculture sector and regional enterprises. The Compact is intended to serve as a catalyst for sustainable economic growth and poverty reduction through key infrastructure investments that capitalize on two of Mali’s major assets, the Bamako-Sénou International Airport, gateway for regional and international trade, and the Niger River for irrigated agriculture.

Results underway

The Compact has been signed and entry into force is forthcoming.

Obligations by Sector
 in millions



Nicaragua



Summary

In Nicaragua, the five-year Compact seeks to support those living in the Leon and Chinandega region by significantly increasing incomes of rural farmers and entrepreneurs. The Compact will provide \$175 million to reduce transportation costs, improve access to markets, strengthen property rights, increase investment, and raise incomes for farms and rural businesses.

Results underway

- The property regularization component of the Compact has been launched with the awarding of the first 26 “clean” titles to beneficiaries in León. This includes 16 urban and 10 rural titles, many of which went to female landowners. These titles are the first of 43,000 to be delivered under the compact.
- Rural producers are receiving technical assistance and training that has resulted in achieving export contracts at a price double of what they usually obtain on the local market.
- Investment promotion in the region has played a role in attracting a large investment from a Central American company.

Key Country Facts

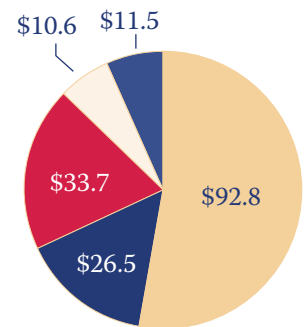
Population5,486,685
 GNI Per Capita.....\$910

Key Compact Facts

Signed.....July 14, 2005
 Total Amount.....\$175 million
 Duration 5 years

Obligations by Sector

in millions



- Fiscal/Procurement Agent
- Program Administration & Monitoring and Evaluation
- Rural Business Development
- Property Regularization
- Transportation



Vanuatu

Key Country Facts

Population 207,331
 GNI Per Capita..... \$1,600

Key Compact Facts

Signed..... March 2, 2006
 Amount..... \$65.69 million
 Duration 5 years

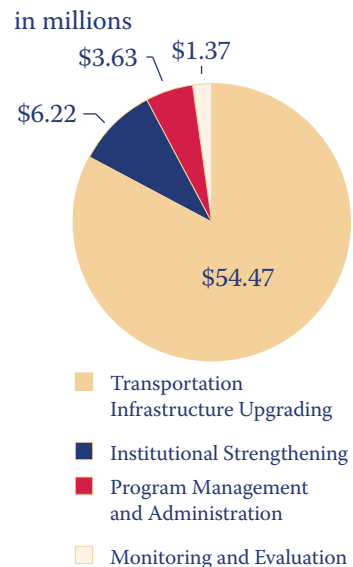
Summary

The five-year, \$65 million Compact addresses the country’s poor transportation infrastructure. Consisting of eleven infrastructure projects – including roads, wharfs, an airstrip, and warehouses – the program seeks to benefit poor, rural agricultural producers and providers of tourist related goods and services by reducing transportation costs and improving the reliability of access to transportation services.

Results underway

Procurement notices have been published for various compact programs relating to infrastructure.

Obligations by Key Sector



Threshold Agreements

Explaining a Threshold Program

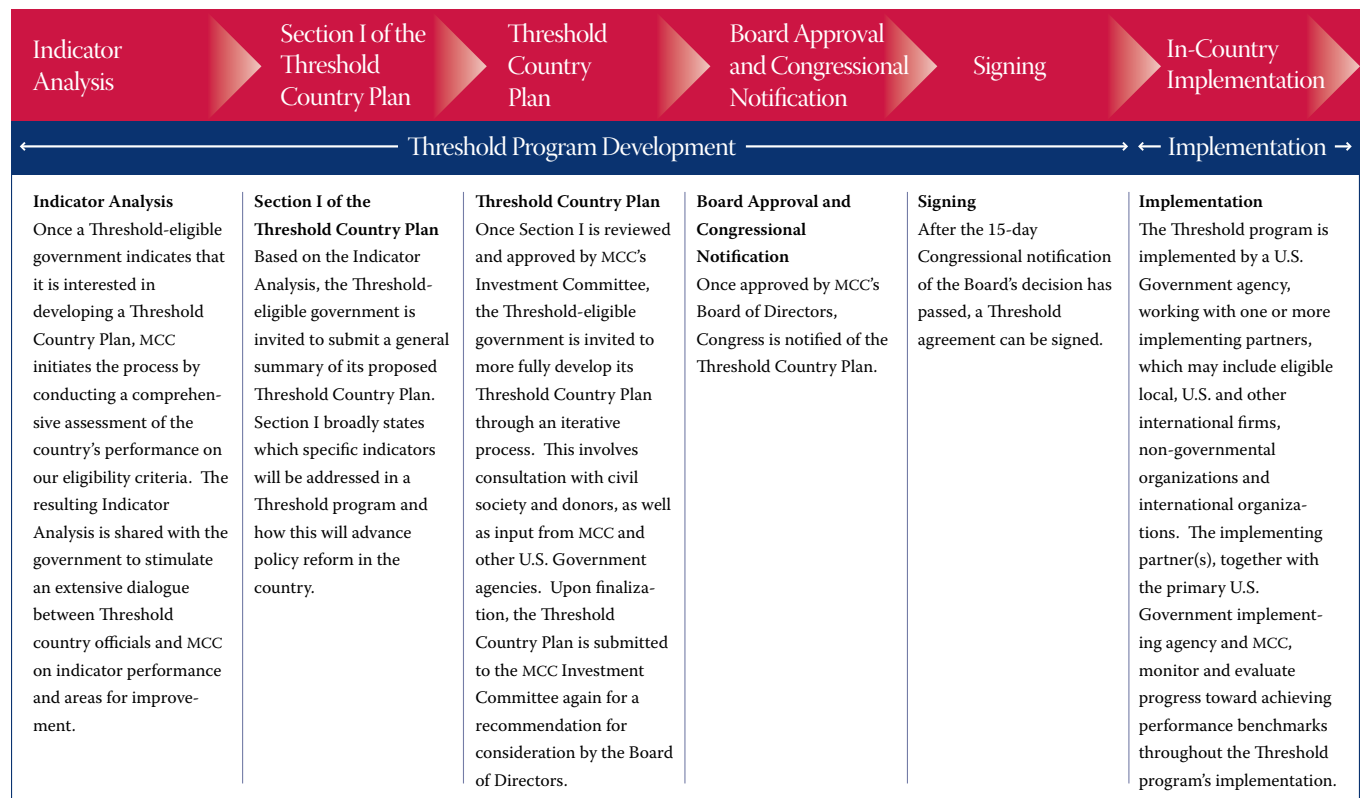
MCC’s Board of Directors selects countries for Threshold status based on their performance on the 16 policy indicators tracked by MCC as well as their demonstrated commitment to undertake additional reforms to improve performance on one or more of the indicators. Threshold program assistance is used to help the selected countries address their specific policy weaknesses indicated by their policy indicators scores. It is intended to help countries on the “threshold” of fully qualifying on all MCC’s indicator criteria. MCC’s authorizing legislation allows up to 10 percent of MCC’s funding to be used for the Threshold program.

Threshold Programs

Explore on the following pages summaries of MCC’s 11 current Threshold programs.

The Making of a Threshold Program

The following chart illustrates the various stages of developing a MCC Threshold Country Plan:





Albania

Summary

Reducing corruption is the primary focus of the \$13.9 million Albania Threshold program. Albania is receiving assistance from MCC for three programs aimed at reforming tax administration, public procurement, and business administration. The program is designed to increase the national tax base and combat the corruption and red tape that make it difficult to start a new business.

USAID is administering this program on MCC's behalf.



Burkina Faso

Summary

Burkina Faso's \$12.9 million Threshold program seeks to improve performance on girls' primary education completion rates. Specific interventions include the construction of girl-friendly schools, teacher training, providing take-home dry rations to girls who maintain a minimum 90 percent school attendance rate, and literacy training for mothers.

USAID is administering this program on MCC's behalf.

Indonesia



Summary

The \$55 million Threshold program seeks to ensure that Indonesia immunizes at least 80 percent of children under the age of one for diphtheria, tetanus, and pertussis and 90 percent of all children for measles on a sustained basis. The Threshold program also is intended to help curb public corruption by reforming the judiciary and anti-corruption institutions and assisting with procurement reform.

USAID is administering this program on MCC's behalf. In addition, portions of the program are being implemented by the U.S. Department of Justice.

Jordan



Summary

The \$25 million Jordanian Threshold program aims to strengthen democratic institutions by supporting Jordan's homegrown efforts to broaden public participation in the political and electoral process, increasing local government transparency and accountability, and enhancing the efficiency and effectiveness of customs administration.

USAID is administering this program on MCC's behalf.



Malawi

Summary

Malawi is implementing 15 specific interventions over the two-year period of its \$20.9 million Threshold program aimed at preventing corruption, enhancing oversight functions, and building enforcement and deterrence capacity. The interventions intend to create more effective legislative and judicial branches of government, provide support for lead anti-corruption agencies, strengthen independent media coverage, and expand and intensify the work of civil society organizations.

USAID is administering this program on MCC's behalf. In addition, portions of the program are being implemented by the U.S. Department of Treasury and the U.S. Department of Justice.



Moldova

Summary

The \$24.7 million Moldovan Threshold program seeks to reduce corruption in the public sector through reforms to the judicial, health, tax, police, customs systems, and the national anti-corruption agency. The reforms will complement Moldova's national strategy aimed at reducing corruption and will help civil society and the media monitor the government's progress.

USAID is administering this program on MCC's behalf. In addition, portions of the program are being implemented by the U.S. Department of Justice.

Paraguay



Summary

The principal objective of the \$34.6 million Paraguay Threshold program is to reduce corruption. The program aims to strengthen the rule of law by increasing penalties for corruption and to build a transparent business environment by confronting informal business transactions. The Threshold program also has a business development component aimed at reducing the number of days necessary to start a business.

USAID is administering this program on MCC's behalf. In addition, portions of the program are being implemented by the U.S. Department of Treasury.

Philippines



Summary

The \$20.7 million Philippines Threshold program aims at improving revenue administration and anti-corruption efforts in the Philippines. Specifically, the program is intended to reduce corruption by strengthening the Office of the Ombudsman and strengthening enforcement within specific offices of the Department of Finance.

USAID is administering this program on MCC's behalf.



Tanzania

Summary

The \$11.2 million Tanzania Threshold program is focused on four specific anti-corruption initiatives: 1) building the nongovernmental sectors' monitoring capacity; 2) strengthening the rule of law for good governance; 3) establishing a Financial Intelligence Unit; and 4) curbing corruption in public procurement.

USAID is administering this program on MCC's behalf. In addition, portions of the program are being implemented by the U.S. Department of Treasury and the U.S. Department of Justice.



Ukraine

Summary

MCC has signed a \$45 million Threshold program with Ukraine that is intended to address corruption in higher education and the judiciary, create internal inspection divisions in government institutions, and help streamline government regulations in customs and other areas. This program also aims to strengthen civil society and the media's ability to monitor and expose corruption.

USAID is administering this program on MCC's behalf. In addition, portions of the program are being implemented by the U.S. Department of Justice.

Zambia



Summary

The \$22.7 million Zambia Threshold program focuses on reducing corruption and improving government effectiveness. The program is funding three components aimed at increasing control of corruption within the public sector, improving public service delivery to the private sector, and strengthening border management of trade.

USAID is administering this program on MCC's behalf.

Financial Audit and Management's Comments



USAID
FROM THE AMERICAN PEOPLE

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, 2006 AND 2005**

AUDIT REPORT NO. M-000-07-001-F
November 14, 2006

WASHINGTON, DC



*Office of Inspector General
for the
Millennium Challenge Corporation*

November 14, 2006

The Honorable John J. Danilovich
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, 2006
and 2005 Report No. M-000-07-001-F

Dear Mr. Ambassador:

Enclosed is the final report on the subject audit. The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of Williams, Adley & Company, LLP to audit the financial statements of the Millennium Challenge Corporation (MCC) for the period ending September 30, 2006. The contract required that the audit be performed in accordance with generally accepted government auditing standards (GAGAS), Office of Management and Budget (OMB) Bulletin 06-03, *Audit Requirements for Federal Financial Statements*, and the GAO/PCIE *Financial Audit Manual*.

In its audit of the MCC's financial statements for the period ending September 30, 2006 the auditors found:

- that the financial statements were fairly presented in conformity with generally accepted accounting principals (GAAP),
- six reportable conditions in the internal controls over financial reporting and its operation. Five of the six reportable conditions are material weaknesses, and
- three instances of material noncompliance with laws, regulations, contracts, and agreements.

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The material weaknesses identified in MCC's internal controls process increases the need for MCC to develop written policies and procedures to streamline its financial operations. Under current operating procedures, the material weaknesses, increases the risk of improper recording, unauthorized transactions, omissions, potential funds control violations and noncompliance with laws, regulations, contracts and grant agreements. Williams Adley & Company LLP reported the following internal control weaknesses:

1. MCC's policies and procedures were not always complete and consistent. (material weaknesses)
2. MCC's policies for disbursing advances to grantees do not accommodate effective cash management. (material weakness and noncompliance)
3. MCC does not have a property management system. (material weakness)
4. MCC did not properly record compact expenses during the fiscal year. (material weakness)
5. MCC's Chief Financial Officer was not an integral part of the compact/grant processes. (material weakness).
6. MCC's travel disbursement controls and procedures do not permit effective and efficient management of travel.

Williams, Adley & Company, LLP also reported instances of noncompliance with laws, regulations, contracts, and grant agreements, inclusive of those referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) and disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards, issued by the Comptroller General of the United States, and OMB Bulletin 06-03, *Audit Requirements for Federal Financial Statements*. The instances of noncompliance are:

1. MCC did not fully comply with FFMIA and the Government Performance Results Act (GPRA). (material noncompliance)
2. MCC did not fully comply with Federal Information Security Management Act (FISMA). (material noncompliance)
3. MCC's policies for disbursing advances to grantees do not accommodate effective cash management. (material noncompliance)

In carrying out its oversight responsibilities, the OIG reviewed Williams, Adley & Company, LLP's report and related audit documentation. This review, as differentiated from an audit in accordance with GAGAS was not intended to enable the OIG to express, and we do not express, opinions on MCC's financial statements, or internal control; on whether MCC's financial management systems substantially complied with FFMIA; or on MCC's compliance with other laws and regulations. Williams, Adley & Company, LLP is responsible for the attached auditor's report, dated November 14, 2006, and the conclusions expressed in the

report. However, our review disclosed no instances on where Williams, Adley & Company, LLP did not comply, in all material respects, with applicable standards.

To address the internal control weaknesses and the noncompliance findings reported by Williams Adley & Company, LLP, we are making the following recommendations to MCC's management:

Recommendation No. 1: We recommend that the Millennium Challenge Corporation's Department of Administration and Finance complete the Financial Management Policies and Procedures (FMPP) manual and implement the written policies and procedures for all areas that result in a financial event.

Recommendation No. 2: We recommend that the Millennium Challenge Corporation:

- 2.1 Develop and implement policies and procedures to ensure that the payment schedules and other agreements entered into with grantees are reflective of the U. S. Treasury requirements concerning advances and immediate cash advances.**
- 2.2 Develop and implement policies and procedures to ensure that disbursement requests from the accountable entity of the recipient countries follow the official format that documents the cash requirements for each month of the quarterly period.**
- 2.3 Make and document all payments to the recipient countries on a monthly basis instead of a quarterly basis.**
- 2.4 Establish and implement policies and procedures to ensure that any custodial liabilities, e.g. interest owed to the U.S. government resulting from the grantee advances, are properly recorded.**

Recommendation No. 3: We recommend that the Millennium Challenge Corporation develop and maintain appropriate fixed asset records to ensure accurate reporting and physical control.

Recommendation No. 4: We recommend that the Millennium Challenge Corporation's management:

- 4.1 Require that the final quarterly disbursement requests received from the accountable entity of the recipient countries be made available to the Department of Administration and Finance and the Fiscal Accountability Office.**
- 4.2 Develop and implement policies and procedures that require compact expenses are properly and accurately recorded and reported on a quarterly basis.**
- 4.3 Implement written procedures requiring that appropriate and timely follow-up measures are performed and recorded on late and/or outstanding fund disbursements and/or advances requests.**

- 4.4 Develop and implement policies and procedures that require the Department of Administration and Finance to perform a thorough review of the financial statements to ensure that costs are not omitted.**

Recommendation No. 5: We recommend that the Millennium Challenge Corporation's management revise their policies and procedures to invest the Office of the Chief Financial Officer with the level of responsibility, including role and all levels of authority established by the Chief Financial Officer Act.

Recommendation No. 6: We recommend that Millennium Challenge Corporation management develop and implement internal controls to reject travel expense reimbursement requests that exceed the allowable country per diem limits unless additional electronic authorization is provided.

Recommendation No. 7: We recommend that the Millennium Challenge Corporation's management:

- 7.1 Develop performance goal templates and follow-up training to ensure that Government Performance Results Act (GPRA) requirements are adequately addressed and consistent. We also recommend that baseline data be finalized or performance indicators reviewed and amended such that they can be measured against obtainable data.**
- 7.2 Assess the automated options available to handle MCC operations and develop short range and long range plans for the implementation of the most appropriate information technology structure to address electronic integration of at least the payroll, procurement and travel functions and systems to increase the efficiencies and effectiveness of the processing of financial transactions and decrease the risk of errors.**

In finalizing the report, we have received and considered MCC's response to the draft report and the recommendations included therein.

In its comments, MCC accepted all of the report's recommendations except for 2.1.

At the time of this report, MCC had not accepted recommendation 2.1 and no management decision has been made. Essential elements of a management decision include specific actions, estimated completion dates for implementation, or an explanation and justification regarding why a recommendation is not considered valid by MCC management officials. For recommendation 2.1, MCC has not clearly stated why the recommendation is not valid.

MCC has agreed with recommendations 4 and 6 and has taken actions that implement the recommendation. Accordingly, we are closing these two recommendations upon issuance of the report.

Based on MCC's response to the remaining recommendations, we consider that a management decision has been reached on recommendation no. 1. However, we believe a management decision has not been reached on recommendations nos. 2.2, 2.3, 2.4, 3, 5, 7.1 and 7.2 because the decisions did not specifically identify the activities that MCC plans to conduct to implement the recommendation and/or the decision did not specify a target implementation date by which the recommendation will be implemented. Specifically:

- Recommendation: 2.2 --not specific and no target implementation date
- Recommendation: 2.3 --no target implementation date
- Recommendation: 2.4 --not specific and no target implementation date
- Recommendation: 3 --no target implementation date
- Recommendation: 5 --no target implementation date
- Recommendation: 7.1 --not specific and no target implementation date
- Recommendation: 7.2.--no target implementation date

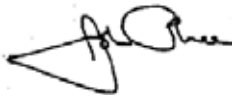
We discussed the lack of specificity and target dates in the management decisions with the MCC staff and they stated that they will study these decisions and revise them accordingly.

Please forward to us within 30 days your revised management decisions for the above recommendations.

Please inform us when you have taken final action on the recommendations.

The OIG appreciates the cooperation and courtesies extended to our staff and the staff of Williams, Adley & Company, LLP during the audit. Please contact me or Mr. Manuel S. Avila, IG/MCC/FA at (202) 712-1897, if you have any questions concerning this report.

Sincerely,



John M. Phee
Assistant Inspector General/MCC

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Williams Adley & Company, LLP
Certified Public Accountants/Financial Management Consultants

Independent Auditors' Report

Inspector General
United States Agency for International Development

Board of Directors
Millennium Challenge Corporation

We have audited the accompanying Statements of Financial Position of the Millennium Challenge Corporation (MCC or Corporation) as of September 30, 2006 with summary totals for September 30, 2005, and the related Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources for the year ended September 30, 2006 with summary totals for September 30, 2005. These financial statements are the responsibility of Corporation management. Our responsibility is to express an opinion on these financial statements based on our audit.

In connection with our audit, we also considered the MCC's internal control over financial reporting and tested the MCC's compliance with certain provisions of applicable laws, regulations, contracts and grant agreements that could have a direct and material effect on the financial statements.

SUMMARY

As stated in our opinion, we concluded that the MCC's financial statements as of and for the year ended September 30, 2006 with summary totals for September 30, 2005 are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal control over financial reporting and its operation resulted in six matters that we consider to be reportable conditions. We believe that five of the six reportable conditions are material weaknesses.

- 1 MCC's Policies and Procedures Were Not Always Complete and Consistent (material weakness)
2. MCC Policies for Disbursing Advances to Grantees Do Not Accommodate Effective Cash Management (material weakness and noncompliance)

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3. MCC Does Not Have a Property Management System (material weakness)
4. MCC Did Not Properly Record Compact Expenses During the Fiscal Year (material weakness)
5. MCC's Chief Financial Officer Was Not an Integral Part of the Compact/Grant Processes (material weakness)
6. MCC's Travel Disbursement Controls and Procedures Do Not Permit the Effective and Efficient Management of Travel (reportable condition)

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, inclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed three instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*:

1. MCC did not fully comply with FFMIA and Government Performance and Results Act (GPRA) (material noncompliance)
2. MCC did not fully comply with Federal Information Security Management Act (material noncompliance)
3. MCC Policies for Disbursing Advances to Grantees Does Not Accommodate Effective Cash Management (material weakness and noncompliance)

The following sections discuss our opinion on the MCC's financial statements, our consideration of the MCC's internal control over financial reporting, our tests of the MCC's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements, and the distribution of our report. The status of prior year findings is included as Appendix A. Management's response to the findings and our evaluation of said response is included as Appendix C and Appendix B, respectively.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying Statements of Financial Position of the Corporation as of September 30, 2006 with summary totals for September 30, 2005, and the related Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources for the year ended September 30, 2006 with summary totals for September 30, 2005. These financial statements are the responsibility of Corporation management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial statement audits contained in

Government Auditing Standards, issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial positions of the Corporation as of September 30, 2006 with summary totals for September 30, 2005, and changes in net position, cash flows and budgetary resources for the year ended September 30, 2006 with summary totals for September 30, 2005, in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the basic financial statements of the Corporation taken as a whole. The information contained in the Management's Discussion and Analysis and Performance Section is not a required part of the financial statements, but is supplementary information required by the Federal Accounting Standards Advisory Board guidance. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the information. However, we did not audit the information and do not express an opinion thereon.

The accompanying Statements of Functional Expenses for the year ended September 30, 2006, and as summarized for year ended September 30, 2005, are presented for purposes of additional analysis and are not a required part of the basic financial statements. This statement is the responsibility of the management of the Corporation. The information in this statement has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our fiscal year 2006 audit, we considered MCC's internal control over financial reporting by obtaining an understanding of MCC's internal control, determined whether internal controls had been placed into operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 06-03 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982* (FMFIA), such as those controls relevant to ensuring efficient operations. The objective of

our audit was not to provide assurance on internal control; accordingly, we do not provide an opinion on internal control.

Our consideration of internal control over financial reporting would not necessarily disclose all matters that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect MCC's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses or noncompliance may occur and not be detected.

We noted six matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that five reportable conditions are material weaknesses. All material weakness and the reportable condition are described on pages 4-15.

MATERIAL WEAKNESSES

MCC's Policies and Procedures Were Not Always Complete and Consistent (material weakness)

Condition:

During fiscal year (FY) 2006, the Millennium Challenge Corporation (MCC) used various processes to address the financial aspects of its operations. These processes evolved during the year as the organization grew in both number of personnel and span of operations. However, during this growth, the development and implementation of final written policies and procedures to guide MCC's streamlined operational structure was not adequately addressed. During the fiscal year, MCC lacked final written policies and procedures. Written policies and procedures must be in place to ensure operational efficiencies, risk reduction, and consistent application. Several policies and procedures, i.e. advances, budget, and accruals, remained in draft form, throughout the year. Additionally, several procedures do not address the responsible positions at the various control levels for the processing of data/data entry functions, or submission and approval levels and procedures in the areas of fixed assets and the open obligations review required revision.

While the current Department of Administration and Finance (A&F) management team has emphasized the preparation and issuance of a comprehensive financial management policies and procedures (FMPP) manual, as of the end of the FY, such a manual was being drafted.

MCC has hired contractors to assist in the production of the FMPP manual by December 31, 2006.

Criteria:

The GAO “*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. The documentation should appear in management directives, administrative policies, or operating manuals. Also, information should be recorded and communicated to management and others within the entity who need it and in a form and within a timeframe that enables them to carry out their internal control and other responsibilities.

Additionally, management and employees should establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control and conscientious management. A positive control environment is the foundation for all other standards. It provides discipline and structure as well as the climate which influences the quality of internal controls.

Cause:

Division of Finance (within the Department of A&F) management stated that they have not had the available personnel to sufficiently dedicate to the development and issuance of final policies and procedures during the year.

Effect:

The lack of sufficient detail and accountability in the procedures produced inconsistent application of controls and processes, and increased the risk of errors, improper recording, unauthorized transactions, omissions and potential funds control violations. Furthermore, the lack of formal procedures can result in noncompliance with laws and regulations. Also, the effective and efficient processing of financial transactions is diminished. Examples of the effect of the lack of final MCC policies and procedures include:

- The policy established for the proper recording of fixed assets was not followed during the year, thereby resulting in potentially incorrect posting of asset transactions.
- Employees travel claims were greater than the approved per diem rates.
- Compact expenses were not reported in the third quarter financial statements.

Recommendation #06-01:

We recommend that Millennium Challenge Corporation’s Department of Administration and Finance complete the Financial Management Policies and Procedures (FMPP) manual and implement the written policies and procedures for all areas that result in a financial event.

Management Response:

MCC accepts the recommendation and is currently implementing relevant corrective action. Specifically, the Division of Finance (within the Department of Administration and Finance) initiated an effort during the summer 2006 to develop and implement a comprehensive corporate Financial Management Policies and Procedures (FMPP) manual. The Division is utilizing contractor support in this endeavor. The initial version of the FMPP manual is slated to be completed and formally institutionalized by December 31, 2006.

MCC Policies for Disbursing Advances to Grantees Do Not Accommodate Effective Cash Management (material weakness and noncompliance)

Condition:

MCC entered into various compacts and provided several advances during fiscal year 2006. MCC personnel indicated that monthly disbursements were made based upon the quarterly request. However, we noted that for most Millennium Challenge Authorities (MCAs), MCC disbursed funds on a quarterly basis based upon the disbursement request, rather than monthly. We noted that several disbursements were not used within 30 days nor the quarter.

Country	Date of Disbursement	Amount of Disbursement	Projected Cash Balance at September 30, 2006	Date when disbursement was completely expended
Madagascar	July 28, 2005	\$ 2,500,924	-	March 30, 2006
	December 13, 2005	\$ 1,755,506	-	June 30, 2006
	May 31, 2006	\$ 5,391,665	\$2,311,342	Not expected to be expended by September 30, 2006
Georgia	May 2, 2006	\$ 3,603,404	\$221,594	Not expected to be expended by September 30, 2006
	September 15, 2006	\$6,509,706	6,509,706	
Honduras	February 28, 2006	\$ 1,646,545	\$138,840	Not expected to be expended by September 30, 2006
	September 29, 2006	\$1,369,849	\$1,369,849	
Cape Verde	February 1, 2006	\$ 7,526,864	\$3,913,663	Not expected to be expended by September 30, 2006
Vanuatu	June 30, 2006	\$ 1,127,055	\$1,023,658	Not expected to be expended by September 30, 2006
	August 9, 2006	\$ 219,504	\$219,504	
	September 6, 2006	\$ 111,688	\$111,688	

Country	Date of Disbursement	Amount of Disbursement	Projected Cash Balance at September 30, 2006	Date when disbursement was completely expended
	September 18, 2006	\$ 116,377	\$116,377	
Nicaragua	June 30, 2006	\$ 1,483,399	433,889	Not expected to be expended by September 30, 2006
	August 28, 2006	\$ 378,550	378,550	
	August 31, 2006	\$ 289,110	289,110	

The Department of the Treasury's Financial Management Service publications did not envision the inclusion of sovereign governments; however, in the analysis of cash management, we used the Treasury Financial Manual (TFM) as a valuable source of sound business practices. The TFM is the Department of the Treasury's official publication for financial accounting and reporting of all receipts and disbursements of the Federal Government. The purpose of the TFM is to provide policies, procedures, and instructions for Federal departments and agencies to follow in carrying out their fiscal responsibilities.

Also, through various OMB Circulars, OMB has attempted to address the need for advances to cover immediate cash needs or timely disbursements of an entity for direct program costs for carrying out the purpose of the approved program or project. Thus, funds paid to a grantee are not to be held, but are to be promptly applied to the grant purpose. Although the timeframe for immediate cash needs has not been clearly defined by OMB, the general rules employed by various Federal agencies are 30 days for non-governmental entities as outlined in the TFM. Based upon this definition, MCC has provided Federal funds in excess of immediate cash needs.

Criteria:

Per the Appropriations Law Volume II, advances under an assistance program are intended to accomplish the program purposes and not to profit the recipient other than in the manner and extent specified in the program. Section 2025 of the Treasury Financial Manual –Volume 1, Part 6-Chapter 2000, states that advances to a recipient organization will be limited to the minimum amounts necessary for immediate disbursement needs and will be timed to be in accordance with the actual immediate cash requirements of the recipient organization in carrying out the purpose of an approved program or project. The timing and amount of cash advances will be as close as is administratively feasible to actual disbursements by the recipient organization.

Best business practice defines immediate cash needs as money used for the purpose of carrying out the Compact's approved programs within a thirty day period. Also, when funds are drawn from Treasury before it is needed, or in excess of current needs, the government loses the use of the funds.

Cause:

The approved agreements entered into by MCC with MCA Madagascar and other compact grantees indicate that quarterly advances will be provided based upon their estimated costs. Although, MCC's management has changed the policy, it has not been effectively implemented and monitored to ensure that it occurs.

Effect:

MCC received a total of \$304,000 in interest from compact countries during the first three quarters of FY 2006 and remitted this amount to Treasury. As of the end of FY 2006 the additional \$174,402 of interest is due to MCC. MCC has not adopted an approach that provides funds only for a grantee's immediate cash needs and reduces the risk of misappropriation.

Recommendation # 06-02:

We recommend that Millennium Challenge Corporation:

- (1) Develop and implement policies and procedures to ensure that the payment schedules and other agreements entered into with grantees are reflective of the U.S. Treasury requirements concerning advances and immediate cash needs.
- (2) Develop and implement policies and procedures to ensure that all disbursement requests from the accountable entity of the recipient countries follow the official format that documents the cash requirements for each month of the quarterly period.
- (3) Make and document all payments to the recipient countries on a monthly basis instead of a quarterly basis.
- (4) Establish and implement policies and procedures to ensure that any custodial liabilities, e.g. interest owed to the U.S. government resulting from the grantee advances, are properly recorded.

Management Response:

MCC Management accepts recommendations 2.2, 2.3, and 2.4. Regarding recommendation 2.1, MCC intends to follow sound cash management practices, will disburse funds consistent with the GAO policy based upon what is needed to meet grant purposes in any given quarter, though the funds will be released in tranches following a monthly schedule.

MCC has begun implementing needed corrective actions. The MCC FMPP manual (currently being developed – see above management response to recommendation 1) will contain definitive documentation and disbursement requirements for transferring funds to compact countries. Furthermore, the Division of Finance, in coordination with the National Business Center (MCC's financial services provider) has already implemented procedures to disburse funds to compact countries monthly in accordance with identified funding needs per pertinent quarterly disbursement requests.

MCC Does Not Have a Property Management System (material weakness)

Condition:

We noted that MCC reported \$5,656,567 in property as of June 30, 2006; however, they were unable to provide detailed records to support the amount reported. The MCC does not have a property management system that provides detail information on original cost, date of purchase, location, useful life, depreciation, and accumulated depreciation.

For the year end financial statements, sufficient analysis was performed to ensure consistent application of the capitalization policy and to determine an appropriate measure of depreciation expense to ensure that fixed assets would be fairly stated.

Criteria:

OMB Circular A-127 "*Policies and Standards for Financial Management Systems*" states that financial management in the Federal government requires accountability of financial and program managers for financial results of actions taken, control over the Federal government's financial resources and protection of Federal assets. To enable these requirements to be met, financial management systems must be in place to process and record financial events effectively and efficiently, and to provide complete, timely, reliable and consistent information for decision makers and the public.

The Joint Financial Management Improvement Program (JFMIP) standards require that property management systems assist managers in collecting and maintaining information for financial reporting in accordance with generally accepted accounting principles and managing the various types of property. Additionally, they should assist managers in ensuring that assets are safeguarded against improper use or disposition.

Cause:

MCC did not create a property management system to support its property financial policy nor did management ensure that an accountable employee was assigned to ensure its implementation.

Effect:

The quarterly financial statements may be misstated due to the inaccurate recording and reporting of property and depreciation expense. In the June 30, 2006 financial statements, no depreciation expense was recorded. Lack of sufficient controls over property can result in loss, waste and abuse of federal resources.

Recommendation #06-03:

We recommend that Millennium Challenge Corporation develop and maintain appropriate fixed asset records to ensure accurate reporting and physical control.

Management Response:

MCC management accepts the recommendation. The Department of Administration and Finance has begun planning and defining requirements for implementing a viable property management system and associated controls and processes, including periodic physical counts to verify the Corporation's property holdings and ensure the propriety of perpetual property records and related financial balances.

MCC Did Not Properly Record Compact Expenses During the Fiscal Year (material weakness)

Condition:

As a result of our review of the third quarter financial statements, we noted that MCC did not report any compact program costs. Although MCC had received disbursement requests that can be used to post the expenses incurred, nothing was recorded. According to the compact and disbursement agreement, each MCA is required to submit quarterly disbursement requests that include the expenses incurred to date. These requests are due regardless of the need for funding. The requests should provide the following:

- Previous quarter advances;
- Previous quarter disbursements;
- Estimated expenses; and
- Next quarter's advance request.

For the year end financial statements, MCC recorded compact expenses of \$8,493,394. Additional analysis was performed utilizing the disbursement requests to increase expenses recorded and to ensure that advances and compact expenses were fairly stated.

Criteria:

OMB Circular A-136 "*Financial Reporting Requirements*", Section II.4.4.3, Program Costs, states that the reporting entity should report the full cost of each program's output, which consists of (a) direct cost and indirect costs of the output, and (b) the costs of identifiable supporting services provided by other segments within the reporting entity and by other reporting entities. The reporting entity should accumulate and assign costs in accordance with the costing methodology in Statement of Federal Financial Accounting Standard (SFFAS) No. 4.

In Section 3.2 of the disbursement agreements, it states that the MCA shall deliver to MCC a completed MCC disbursement request in the form attached hereto as Exhibit A, and otherwise satisfactory to MCC in content. Exhibit A section E, commitment and expenditure report provides for the reporting of cumulative actual redisbursements and projected redisbursements.

Cause:

The Fiscal Accountability Office is responsible for the collection of the required quarterly expense/disbursement requests, and they have encountered many problems recovering the reports from the various MCAs. The requests are not sent directly to the Division of Finance and must be provided by the Fiscal Accountability Office. Additionally, MCC is not enforcing the requirement and the compact and disbursement agreements appear to lack sufficient strictures for noncompliance.

MCC did not perform a sufficient review of the financial statements to address the omission of the compact expenses.

Effect:

As a result of the nonrecording of compact expense, the MCC quarterly financial statements were inaccurate and MCC management's ability to rely on the financial statements to make informed decisions was impaired.

Recommendation #06-04:

We recommend that Millennium Challenge Corporation's management:

- (1) Require that the final quarterly request received from the accountable entity of the recipient countries be made available to the Department of Administration and Finance and the Fiscal Accountability Office.
- (2) Develop and implement policies and procedures that ensure compact expenses are properly and accurately recorded and reported on a quarterly basis
- (3) Implement written procedures requiring that appropriate and timely follow-up measures are performed and are recorded for historical reference on incomplete, outstanding, or late disbursement requests.
- (4) Develop and implement policies and procedures that require the Department of Administration and Finance to perform a thorough review of the financial statements to ensure that costs are not omitted.

Management Response:

MCC management accepts the recommendations. The Division of Finance has already implemented quality assurance and review procedures to help ensure that compact disbursement requests/reports, which are to include compact expense information, are received timely, are complete, and that relevant financial information from such requests are properly included in quarterly financial statements and reports prepared by NBC. In the event of missing or late reports/requests, Division of Finance personnel will contact the

pertinent accountable officials to obtain the reports/requests, and document such. Relevant policies and procedures will be included in the FMPP manual.

MCC's Chief Financial Officer Was Not an Integral Part of the Compact/Grant Processes (material weakness)

Condition:

Based on interviews and observations, we noted that MCC's Division of Finance was not integrally involved in the compact/grant processes to ensure that the financial aspects are addressed, recorded and reported in their proper sequence and appropriate timing. The Chief Financial Officer or his designees should be integrally involved in all MCC operations that result in a financial transaction. The CFO should be integrally involved in the:

1. establishment of the compact amount to ensure that there is sufficient appropriations available,
2. development of grant policies and procedures to ensure that they are in compliance with Federal government laws and regulations and to ensure that sufficient financial information is provided to MCC to accomplish its responsibilities,
3. review of compacts in order to initiate accounting transactions in the system and budget transactions with OMB, and
4. establishment of the reporting structure to ensure that financial information is provided timely and in the format necessary for required financial reporting.

Criteria:

According to the CFO Act of 1990, "An agency Chief Financial Officer shall oversee all financial management activities relating to the programs and operations of the agency." Under the Act, an agency CFO's responsibility will extend to every aspect of financial management related to operating agency programs. Government wide organizational change is needed to vest the CFOs with authority related to accounting, budget execution, and other financial management operations. This will ensure that one person, who is part of top management, has overall responsibility for establishing and implementing effective financial management policies, internal controls, and financial management systems.

Cause:

During fiscal year 2005, MCC management developed the selected compacts based on informal procedures. Therefore, the Chief Financial Officer's involvement was based on an informal basis, and was not included in the official procedures that were developed during fiscal year 2006.

Effect:

This condition can result in the lack of (1) control over pertinent financial management activities, (2) sufficient information to accurately report on compact expenses and advances,

and (3) control over disbursement to ensure compliance with Treasury cash management requirements. Additionally, it can result in confusion over the financial reporting required and the timeframe required.

Recommendation #06-05:

We recommend that Millennium Challenge Corporation's management revise their policies and procedures to invest the Office of the Chief Financial Officer with the level of responsibility, role, and all levels of authority established by the Chief Financial Officer Act.

Management Response:

MCC management accepts the recommendation and will take necessary steps to establish and implement required policies, procedures, and organizational protocol to ensure that the Corporation's CFO is appropriately involved with the financial management operations entity-wide.

REPORTABLE CONDITION

MCC's Travel Disbursement Controls and Procedures Do Not Permit the Effective and Efficient Management of Travel (reportable condition)

Condition:

MCC follows the Federal Travel Regulations and has an overall policy related to travel. However, prior to February 2006, MCC was using blanket travel authorizations (TA) to serve as an approval for employee travel. Once MCC approved the blanket TA, it was submitted to National Business Center (NBC) to post an obligation within Oracle. After February, MCC modified the travel policy that instituted the individual TA's that outlined the specific purpose of the employee's travel. NBC no longer posts travel obligations in advance in Oracle but obligates and pays the travel vouchers, simultaneously.

Similar to FY 2005, MCC requires all employees to post their travel expenses online in E-Travel. Although the travel voucher process is electronic, E-Travel does not interface with Oracle Federal Financials. Therefore, an NBC accounting technician must manually enter each voucher. During our travel testing, we noted twenty-six instances totaling \$97,802 for which employees' receipts were not available. We also noted the following:

1. Eleven of 115 (10%) travel vouchers totaling \$869 exceeded per diem rates;
2. Six of 115 (5%) vouchers equaling \$557 consisted of expenses in excess of \$75 and were not supported; and
3. Four of 115 (3%) vouchers totaling \$35,663 were not approved by the travel manager within E-Travel.

MCC enhanced its travel policy in August 2006. MCC management changed the Corporation's supporting documentation requirements to require travelers to scan into the E-travel system and electronically attach to the pertinent travel vouchers receipts for claimed expenses of \$75 or more. Division of Finance personnel are responsible for reviewing submitted vouchers to ascertain that required receipts are electronically attached to travelers' vouchers. Travelers who do not scan and attach their required receipts to vouchers are contacted by Division of Finance staff to obtain "missing" receipts.

Criteria:

U.S. General Services Administration (GSA) Federal Travel Regulations Chapter 301 "Temporary Duty (TDY) Travel Allowances" states that traveler is responsible for expenses over the reimbursement limits established in this chapter. The traveler's agency will not pay for excess costs resulting from circuitous routes, delays, or luxury accommodations or services unnecessary or unjustified in the performance of official business. Also, receipts shall be required to support all lodging costs for which an allowance is claimed under the lodgings-plus per diem system except that a statement instead of a receipt may be accepted for the fee or service charge incurred for the use of Government quarters.

Federal Travel Regulations Chapter 301-7.2 states that it is the responsibility of the head of each agency, or his/her designee, to authorize or approve only those per diem allowances that are justified by the circumstances affecting the travel and are allowable under the specific rules in this part.

Additionally, the "*Standards for Internal Control in the Federal Government*" states that internal controls and all transactions and other significant events need to be clearly documented and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals. Also, information should be recorded and communicated to management and others within the entity who need it and in a form and within a timeframe that enables them to carry out their internal control and other responsibilities.

Cause:

Prior to the finalized procedures distributed in August 2006, management worked from incomplete draft travel procedures. Additionally, the travel manager did not approve the online vouchers in E-travel consistently. Employees are required to retain all receipts that are \$75 or greater and thus, are not required to submit their receipts to the agency. Therefore, for employees on travel during the time of testing, their receipts were unavailable for audit.

Effect:

The lack of sufficient detail and accountability in the procedures can produce inconsistent application of the travel policies and increase the risk of errors, improper recording, unauthorized transactions, omissions, potential funds control violations due to the lack of

obligations and noncompliance with laws and regulations. This also diminished the effectiveness and efficiency with which the financial transactions were being processed.

Recommendation #06-06:

We recommend that Millennium Challenge Corporation's management develop and implement controls to reject travel expense reimbursement requests that exceed the allowable country per diem unless additional electronic authorization is provided.

Management Response:

MCC management accepts the recommendation. The Deputy Chief Financial Officer has instructed the Division of Finance staff not to approve any claimed travel expenses that exceed established limitations as defined by the Federal Travel Regulation (FTR). Furthermore, the Division has instituted procedures to require that a traveler's responsible manager/supervisor be apprised of claimed expenses that are not in compliance with the FTR and/or MCC requirements, and that the manager/supervisor explicitly approve such expenses, but only if allowable per the FTR.

The status of prior years findings is provided in Appendix A. Management's response in its entirety is included in Appendix C.

As required by OMB Bulletin No. 06-03, with respect to internal controls related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

COMPLIANCE WITH LAWS AND REGULATIONS

MCC's management is responsible for complying with laws and regulations applicable to MCC. As part of obtaining reasonable assurance that MCC's balance sheet is free of material misstatements, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 06-03, including the requirements referred to in the FFMIA. We limited our tests of compliance to these provisions and we did not test compliance with all laws, regulations, contracts, and agreements applicable to MCC. Providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 06-03 and FFMIA, we are required to report whether MCC's financial management systems substantially comply with: (1) Federal financial management

systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we relied on the results of a SAS 70 review of the Department of Interior's Oracle Federal Financial System performed by an Independent Audit Firm. The results of that review have been presented to MCC in a separate report. Providing an opinion on compliance with those provisions was not, however, an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests disclosed that the Corporation did not fully comply with the FFMIA, which is required to be reported under *Government Auditing Standards* or OMB Bulletin No. 06-03.

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

The results of our tests disclosed three instances of noncompliance with laws and regulations.

MATERIAL NONCOMPLIANCE

MCC Did Not Fully Comply with FFMIA and GPRA

Condition:

Millennium Challenge Corporation has not fully complied with the following laws and regulations:

- Government Performance and Results Act (GPRA)
- Federal Financial Management Improvement Act (FFMIA)

We noted that the agency performance plans provided to us did not fully comply with GPRA requirements, for example: human, capital and other resources needed to achieve performance goals were not quantified as required. Also, agency performance goals were not written in a manner that could be quantified in several instances and milestones were not included. Therefore, we could not directly link measurement of agency performance goals with the overall strategic plan. In addition, baseline data to be used as performance indicator measurement thresholds were not provided for some indicators.

The FFMIA requires an integrated financial management system. MCC does not have an integrated financial management system. When MCC decided to outsource its accounting operations, MCC selected NBC from the available Federal Centers of Excellence as the best choice to meet its needs. In order to address the needs of MCC, multiple systems, i.e. E-

Travel, procurement, and Federal Personnel and Payroll System (FPPS), are used, but these systems cannot exchange data electronically. The entry of the travel expenses and disbursements must be done manually. The entry of obligations and commitments requires a process of emails, scanning and manual entry into Oracle Federal Financial (OFF) System application. The payroll expenses and disbursements must be uploaded into OFF from FPPS.

Additionally, we obtained and reviewed the Financial Management Controls and Assertion letter and noted the following assertion, “During FY 2006, NBC’s systems were not in substantial compliance with FFMIA requirements. In its assurance statement as of June 30, 2006, NBC asserted that ‘were in substantial non-compliance with FFMIA requirements’.” Subsequently, NBC instituted several corrective actions to address the issues raised and were in substantial compliance by September 30, 2006, per their representation.

Criteria:

The GPRA under United States Code Title 5, Chapter 3, section 306(a)(3) states that strategic plans shall contain, “a description of how the goals and objectives are to be achieved, including a description of the operational processes, skills and technology, and the human, capital, information, and other resources required to meet those goals and objectives.” In addition, under section 306(a)(4), it also requires “a description of how the performance goals included in the plan required by section 1115(a) of Title 31 shall be related to the general goals and objectives in the strategic plan.” Under section 4(b), “Annual Performance Plans and Reports,” it amends section 1115 of Title 31 to, “express such goals in an objective, quantifiable, and measurable form unless authorized to be in an alternative form under subsection (b).” Also, the performance report should evaluate the performance plan for the current fiscal year relative to the performance achieved toward the performance goals in the fiscal year covered by the report.

The FFMIA requires MCC to implement and maintain a financial management system that complies substantially with Federal requirements for an integrated financial management system.

Cause:

MCC is still developing the GPRA process and has not developed system-wide strategic plan implementation standards, formats or procedures at the departmental level. Also, performance measures baseline data is incomplete and as such, in some instances there are no indicators available to measure progress made.

The MCC does not have its own financial system. The Corporation has contracted with NBC to provide accounting and IT services including usage of its OFF application. The MCC is required by government regulations to use Federal Centers of Excellence, of which NBC is one. According to MCC officials, the Corporation has been directed to use the systems available through NBC. MCC believes that in fiscal year 2006, it used the only options available. NBC is working with MCC to provide enhancement to the system to

accommodate MCC's needs within the context of the OMB requirements for Centers of Excellence.

Effect:

Without a performance plan that meets key GPRA requirements MCC management may not have meaningful performance data linked to the strategic objectives and goals of the MCC. The reader of the financial statements is not provided with a clear picture of the accountability and achievements of the Corporation.

Furthermore, because MCC does not have an integrated financial management system, the users may not receive complete, accurate, and timely financial information needed for decision-making purposes because of the inefficiencies caused by the manual processes.

Recommendation #06-07:

We recommend that MCC management:

1. Develop performance goal templates and follow-up training to ensure that Government Performance and Results Act (GPRA) requirements are adequately addressed and consistent. We also recommend that baseline data be finalized or performance indicators reviewed and amended such that they can be measured against obtainable data.
2. Assess the automated options available to handle MCC operations and develop short range and long range plans for the implementation of the most appropriate information technology structure to address electronic integration of at least the payroll, procurement and travel functions and systems to increase the efficiencies and effectiveness of the processing of financial transactions; and decrease the risk of errors.

Management Decision:

MCC accepts the recommendations. Relative to GPRA, the Department of Administration and Finance management is working with various corporate organizations to help ensure that strategic and operational performance goals, including financial management performance, and inter-related and resulting performance data is reliable and consistent.

In regards to system integration, the Department of Administration and Finance is currently considering various potential options and alternatives for increasing the electronic integration, responsiveness, and efficiency of the financial management systems used by the Corporation. The Division of Finance is working with NBC to identify potential opportunities for various financial management systems functions, including enhanced automated financial reporting and cost accumulation. Since MCC outsources its financial management and administrative functions, the Corporation is highly dependent upon its financial and administrative services provider (NBC) to help ensure operation of effective financial systems.

MCC Does Not Fully Comply With The Federal Information Security Management Act (FISMA)

An OIG audit identified significant non-compliance with FISMA requirements. Also, MCC engaged an outside expert to perform an independent security audit. MCC acknowledged that it had not met the majority of the FISMA requirements and proposed a timetable for compliance.

We are reporting this deficiency as required by the guidance issued by the Office of Management and Budget. However, because this deficiency was addressed in a prior OIG audit report, we are not making any recommendation in this report.

MCC Policies for Disbursing Advances to Grantees Does Not Accommodate Effective Cash Management

The internal control finding “MCC Policies for Disbursing Advances to Grantees Does Not Accommodate Effective Cash Management” is also a noncompliance with laws and regulations.

The complete finding and recommendation for this finding is presented in the internal control section of this report. We are not making any recommendations for this finding because we reported and made recommendations for corrective actions in the internal control section.

DISTRIBUTION

This audit was performed pursuant to the Government Corporation Control Act, and is intended solely for the information and use of the United States Congress, the President, the Director of the Office of Management and Budget, Comptroller General of the United States, the Corporation and its Inspector General, and is not intended to be, and should not be, used by anyone other than these specific parties.

Williams, Adley & Company, LLP

October 25, 2006
Washington, D.C.

Appendix A

STATUS OF PRIOR YEAR FINDINGS***Review of Oracle Federal Financial System***

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

Recommendation

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

Status

The NBC performed a SAS 70 review of the Oracle Federal Financial System for the period March 1, 2005 to July 31, 2005. The independent auditors reported that the relevant aspects of the NBC's controls that had been placed in operation are suitably designed to provide reasonable assurance that the specified control objectives would be achieved, except for the following two items:

- OFF requires transactions exceeding a dollar threshold to be approved by certifying officers. The electronic workflow in OFF currently does not require the approval by certifying officers of all such transactions.
- NBC is responsible for monitoring budgetary accounts for MCC. However, OFF limit edits are not designed to prevent obligations from exceeding the allotment.

NBC provided a self-certification asserting no change in the system controls from August 1 to September 30, 2005. No system review was performed for the period October 1, 2004 to February 28, 2005 to assess operational efficiency, effectiveness and transparency

In fiscal year 2006, NBC performed a SAS 70 review for the period October 1, 2005 to July 31, 2006. The independent auditors reported that the relevant aspects of the NBC's controls that had been placed in operation are suitably designed to provide reasonable assurance that the specified control objectives would be achieved, except for the following item:

- OFF requires transactions exceeding a dollar threshold to be approved by certifying officers. The electronic workflow in OFF currently does not require the approval by certifying officers of all such transactions.

Appendix A***MCC's Policies and Procedures Were Not Always Complete and Consistent***

During the fiscal year, the Millennium Challenge Corporation (MCC) has used various processes to address the financial aspects of their operations. These processes have evolved during the year as the organization has grown in personnel and operations. In this growth, however, the development of written policies and procedures to guide MCC's streamlined operational structure has not been a high priority for MCC in several areas. However, written policies and procedures must be in place to ensure operational efficiencies, risk reduction, and consistent application.

Recommendation 05-1:

We recommend that MCC's Office of Finance and Administration revise and reissue written policies and procedures that provide additional specificity in the areas noted above including the Fund Balance with Treasury, financial reporting, payroll processing, accrual generation and reporting, interagency reporting, fixed assets, travel, monitoring and internal grant processes. These policies and procedures should provide the following information at a minimum:

- Position accountable for each step in the process,
- Position responsible for approving/reviewing the information,
- The acceptable internal and external timelines for each step in the process, and
- The specific documentation required determining the authorization, timeliness and review of transaction.

Status

MCC had not issued final policies and procedures in several areas. Therefore, the finding is repeated but revised as finding # 06-1.

MCC's Travel Disbursement Controls and Procedures Do Not Permit the Effective and Efficient Management of Travel

According to MCC's management, MCC has adopted the Federal Travel Regulations as its overall policy related to travel. MCC's internal travel policies and procedures do not permit the effective and efficient management of travel. These procedures do not ensure that travel is adequately planned and managed. Because a blanket travel authorization is used, there is no record that individual travel has taken place and that accounting has occurred for each instance. Additionally, the policy does not require that appropriate coordination include the Office of Finance. For example, the Office of Finance should have knowledge of planned trips, the timing, exceptions to the standard travel policy, and the estimated costs in order to ensure that sufficient obligations have been recorded to cover expenses incurred by MCC travelers. Currently, an initial estimate is prepared annually to fund the blanket travel authorization and the estimate is adjusted quarterly by the controller based upon expense patterns. There are, however, no automated processes in place to ensure that the estimate is

Appendix A

sufficient to cover the travel expenses incurred. This problem is compounded by the untimely filing of travel vouchers thereby increasing the difficulty and reducing the accuracy of the estimation process performed by the controller.

Recommendation #05-2:

We recommend that MCC management:

- (1) Develop and disseminate explicit policies to ensure that employees are aware of and follow the Federal Travel Regulations. Any exception should be documented and approved by a manager/supervisor in writing.
- (2) Institute policies and procedures to ensure proper authorizations and approvals are obtained and coordination with the Office of Finance has occurred for each planned trip prior to travel to ensure that the information is properly captured in the financial management system.
- (3) Develop and institute controls to reject those expenses claimed that exceed the allowable country per diem unless explicit written authorization is provided prior to travel.

Status:

MCC issued a revised policies and procedures in fiscal year 2006. However, we found additional exceptions in fiscal year 2006 related to travel expenses that exceed per diem, and lacked documentation. Also, we noted that no obligations are recorded prior to processing the travel voucher for reimbursement. The finding has been revised. Recommendations 2 and 3 were retained and a new recommendation was added. See recommendation #06-06

MCC Policies for Disbursing Advances to Grantees Does Not Accommodate Effective Cash Management Nor the Appropriate Recording of Custodial Interest Receivable and Payable

MCC entered into a compact with Madagascar in April 2005. The Compact became effective in July 2005, and an immediate advance was provided to MCA Madagascar amounting to \$2,500,924. Based upon information obtained at year-end, MCA Madagascar has expended \$650,000 of the initial advance.

Through various OMB Circulars, OMB has attempted to address the need for advances to cover immediate cash needs or timely disbursements of an entity for direct program costs for carrying out the purpose of the approved program or project. Thus, funds paid to a grantee are not to be held but are to be promptly applied to the grant purpose. Although the timeframe for immediate cash needs has not been clearly defined by OMB, the general rules employed by various Federal agencies are 30 days for non-governmental entities. Based upon this definition, MCC has provided Federal funds in excess of immediate cash needs.

Appendix A

Recommendation #05-3:

We recommend that management:

- (1) Develop policies and procedures to ensure that the payment schedules and other agreements entered into with grantees are reflective of the Treasury requirements concerning advances and immediate cash needs.
- (2) Establish policies and procedures to ensure that any custodial liabilities, e.g. interest owed to the U.S. government resulting from the grantee advances, are properly recorded.

Status:

MCC's policies and procedures have not changed in this area. In fiscal year 2006 more funds have been provided to various MCAs and the timelines between requesting the funds and their use has not improved but worsened. The finding was revised with additional data and recommendations. See recommendation #06-02.

MCC's Human Resources Responsible for Managing Its Financial Operations are Inadequate

During our internal control and substantive testing, we noted that the MCC relies solely on the Controller, with contract assistance, to perform the substantial duties of the Office of Financial Management (OFM). The current range of Controller responsibilities include, but are not limited to, the approval of miscellaneous obligations; monthly, quarterly and yearly financial information review; development of financial policies and procedures; financial statement review; audit coordination; coordination with other agencies including OMB, USAID/OIG, and NBC; and approval of funds availability.

Recommendation #05-4:

We recommend that MCC evaluate and document the need for additional employees in OFM to ensure that proper internal controls are in place to meet the agency's objective and thus, providing the Controller with adequate delegation of authority. Additionally, the roles and responsibilities of the current Controller position and the new positions in OFM should be clearly delineated and communicated.

Status:

MCC took significant steps to improve their human resources in the Office of Finance. They hired an additional five employees including a Chief Financial Officer, Deputy Chief Financial Officers and several accountants. The delineation of their roles and responsibilities will be outlined clearly in the newly revised policies and procedures.

Appendix A

MCC Did Not Fully Comply with FFMIA and GPRA

Millennium Challenge Corporation has not complied with the following laws and regulations:

- Government Performance and Results Act (GPRA)
- Federal Financial Management Improvement Act (FFMIA)

MCC has not developed performance goals and objectives that comply with the requirements of the GPRA. Although MCC has several guiding objectives, they do not meet the requirements of GPRA. The information in Management's Discussion and Analysis are not sufficient to meet GPRA requirements and the goals presented are on a calendar year basis rather than a fiscal year.

The FFMIA requires an integrated financial management system. MCC does not have an integrated financial management system. When MCC decided to outsource its accounting operations, MCC selected NBC from the available Federal Centers of Excellence as the best choice to meet its needs. In order to address the needs of MCC, multiple systems, i.e. E-Travel, procurement, and FPPS, are used but these systems cannot exchange data electronically. The entry of the travel expenses and disbursements must be done manually. The entry of obligations and commitments requires a process of emails, scanning and manual entry into OFF. The payroll expenses and disbursements must be uploaded into OFF from FPPS.

Recommendation #05-5:

We recommend that MCC management:

- (1) Implement their intended corrective actions for preparation of a GPRA based performance goals and objectives by March 2006, as specified in its FMFIA assessment, specifically:
 - Complete the development of a strategic plan for the next six fiscal years that meets OMB requirements.
 - Involve MCC staff in the determination of corporate performance goals.
 - Articulate operational performance goals for FY 2006, that align with the defined strategic goals and submit to the Board and OMB.
- (2) Assess the automated options available to handle MCC operations and develop short range and long range plans for the implementation of the most appropriate information technology structure to address electronic integration of at least the payroll, procurement and travel functions and systems to increase the efficiencies and effectiveness of the processing of financial transactions; and decrease the risk of errors.

Appendix A

Status:

MCC has made improvements in these areas. However, there are remaining issues and thus the finding has been repeated with a revision to the finding for GPRA. See recommendation # 06-07.

MCC Does Not Fully Comply with The Federal Information Security Management Act (FISMA)

In a report issued June 2005, an OIG audit identified significant non-compliance with FISMA requirements. Subsequently, MCC completed its FISMA report to OMB as of September 30, 2005, where it acknowledged that it had not met the majority of the FISMA requirements and proposed a timetable for compliance.

We are reporting this deficiency, as required by the guidance issued by the Office of Management and Budget. However, because this deficiency was addressed in a prior OIG audit report, we are not making any recommendation in this report.

The OIG continues the report significant noncompliances with FISMA requirements in fiscal year 2006.

Appendix B

Management
Comments and Our
Evaluation

We received and evaluated MCC's management comments to the recommendations made in this report. We considered their comments to be generally responsive except for specific exceptions detailed below. Management comments have been included in their entirety in Appendix C.

In its response MCC's management stated that it recognizes the importance of accountability, effective stewardship, and public disclosure related to the resources entrusted to it, and that their goal is to achieve and maintain excellence in financial management, financial reporting and internal control systems. Further, MCC's management commented that it will implement the recommendations as soon as possible to strengthen their systems of internal controls and lend further credibility to their financial statements and overall financial operations. MCC's management went on to address each recommendation. MCC's management also recognized and thanked both the OIG and Williams, Adley & Company, LLP for working closely with them during the audit process and providing counseling and support throughout the year.

Based on MCC's comments, we consider that a management decision has been reached on recommendations 1, 4, and 6 provided in this report but not on recommendations 2, 3, 5, and 7. These recommendations do not provide defined timelines for the corrective action implementation. Also, the corrective actions for recommendation 2.4 and 7.1 require additional details to ensure that the recommendations are appropriately addressed. On recommendation 2.1, management agreed to "the spirit" of the recommendation but has not agreed to the usage of the US Treasury requirements. MCC should report to the OIG when management decision has been reached on the four recommendations and when final action has been taken on the recommendations. The following is a brief summary of MCC's management comments on the seven recommendations included in this report and our evaluation on those comments.

Recommendation No. 1

MCC accepts the recommendation and is currently implementing relevant corrective action. Specifically, the Division of Finance (within the Department of Administration and Finance) initiated an effort during the summer 2006 to develop and implement a comprehensive corporate Financial Management Policies and Procedures (FMPP) manual. The Division is utilizing contractor

Appendix B

support in this endeavor. The initial version of the FMPP manual is slated to be completed and formally institutionalized by December 31, 2006.

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

Recommendation No. 2

MCC Management accepts recommendations 2.2, 2.3, and 2.4. Regarding recommendation 2.1, MCC intends to follow sound cash management practices, will disburse funds consistent with the GAO policy based upon what is needed to meet grant purposes in any given quarter, though the funds will be released in tranches following a monthly schedule.

MCC has begun implementing needed corrective actions. The MCC FMPP manual (currently being developed – see above management response to recommendation 1) will contain definitive documentation and disbursement requirements for transferring funds to compact countries. Furthermore, the Division of Finance, in coordination with the National Business Center (MCC's financial services provider) has already implemented procedures to disburse funds to compact countries monthly in accordance with identified funding needs per pertinent quarterly disbursement requests.

Auditor Evaluation: We conclude that management has not adequately addressed this issue because the response does not address recommendation 2.4; and does not discuss the implementation of recommendation 2.2. Also, the management response does not specify an implementation date for any of the subparts of recommendation 2.

Recommendation No. 3

MCC management accepts the recommendation. The Department of Administration and Finance has begun planning and defining requirements for implementing a viable property management system and associated controls and processes, including periodic physical counts to verify the Corporation's property holdings and ensure the propriety of perpetual property records and related financial balances.

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Auditor Evaluation: We conclude that management has not adequately addressed this issue because no defined timetable has been stated for the corrective action.

Recommendation No. 4

MCC management accepts the recommendations. The Division of Finance has already implemented quality assurance and review procedures to help ensure that compact disbursement requests/reports, which are to include compact expense information, are received timely, are complete, and that relevant financial information from such requests are properly included in quarterly financial statements and reports prepared by NBC. In the event of missing or late reports/requests, Division of Finance personnel will contact the pertinent accountable officials to obtain the reports/requests, and document such. Relevant policies and procedures will be included in the FMPP manual.

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

Recommendation No. 5

MCC management accepts the recommendation and will take necessary steps to establish and implement required policies, procedures, and organizational protocol to ensure that the Corporation's CFO is appropriately involved with the financial management operations entity-wide.

Auditor Evaluation: We conclude that management has not adequately addressed this issue because no defined timetable has been stated for the corrective action.

Recommendation No. 6

MCC management accepts the recommendation. The Deputy Chief Financial Officer has instructed the Division of Finance staff not to approve any claimed travel expenses that exceed established limitations as defined by the Federal Travel Regulation (FTR). Furthermore, the Division has instituted procedures to require that a traveler's responsible manager/supervisor be apprised of claimed expenses that are not in compliance with the FTR and/or MCC requirements, and that the manager/supervisor explicitly approve such expenses, but only if allowable per the FTR.

Appendix B

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

Recommendation No. 7

MCC accepts the recommendations. Relative to GPRA, the Department of Administration and Finance management is working with various corporate organizations to help ensure that strategic and operational performance goals, including financial management performance, and inter-related and resulting performance data is reliable and consistent.

In regards to system integration, the Department of Administration and Finance is currently considering various potential options and alternatives for increasing the electronic integration, responsiveness, and efficiency of the financial management systems used by the Corporation. The Division of Finance is working with NBC to identify potential opportunities for various financial management systems functions, including enhanced automated financial reporting and cost accumulation. Since MCC outsources its financial management and administrative functions, the Corporation is highly dependent upon its financial and administrative services provider (NBC) to help ensure operation of effective financial systems.

Auditor Evaluation: We conclude that management has not adequately addressed this issue because no defined timetable has been stated for the corrective action. Also, the response to recommendation 7.1 does not provide enough detail information to conclude that the finalization of baseline data, review of performance indicators, the development of templates, or performance of follow-up training is part of the corrective action plan.

Appendix C



November 6, 2006

TO: John Phee
Assistant Inspector General

FROM: Michael Ryan /s/
Vice President, Administration & Finance

SUBJECT: Management Response to Draft Independent Auditor's
Report on MCC's Financial Statements for Fiscal Years
Ended September 30, 2006 and 2005, Respectively

We have received the subject draft report and are pleased to note that the independent auditors, Williams, Adley & Company, LLP, are issuing an unqualified opinion on our principal financial statements, namely the Statements of:

- Financial Position;
- Operations and Changes in Net Position;
- Cash flows;
- Functional Expenses; and
- Budgetary Resources.

The auditor's unqualified opinion is being issued despite material internal control weaknesses and noncompliance with selected laws and regulations that have been identified.

The Millennium Challenge Corporation's (MCC) management recognizes the importance of accountability, effective stewardship and public disclosure related to the resources entrusted to it. Our goal is to achieve and maintain excellence in our financial management, financial reporting and internal control systems. Accordingly, we will implement the recommendations as soon as possible to strengthen our systems of internal control and lend further credibility to our financial statements and overall financial operations.

We wish to recognize and thank you, your team and Williams, Adley & Company for working closely with us during the audit process. We look forward to working with you and your staff on the fiscal year (FY) 2007 financial audit. Any questions may be addressed to Mr. Gerald Thomas, Deputy Chief Financial Officer, or to me.

Following are our management decisions and responses to Williams Adley's audit recommendations.

Material Weakness 1: MCC's policies and procedures were not always complete and consistent.

Recommendation 1: Williams, Adley & Company recommends that MCC's Department of Administration and Finance complete the Financial Management Policies and Procedures (FMPP) manual and implement the written policies and procedures for all areas that result in a financial event.

Management Decision: MCC management accepts the recommendation and is currently implementing relevant corrective actions. Specifically, the Division of Finance (within the Department of Administration and Finance) initiated an effort during the summer, 2006 to develop and implement a comprehensive corporate Financial Management Policies and Procedures (FMPP) manual. The Division is utilizing contractor support in this endeavor. The initial version of the FMPP manual is slated to be completed and formally institutionalized by December 31, 2006.

* * * * *

Material Weakness 2: MCC policies for disbursing advances to grantees do not accommodate effective cash management.

Recommendations: Williams, Adley & Company recommends that MCC management:

- 2.1:** Develop and implement policies and procedures to ensure that payment schedules and other agreements entered into with grantees are reflective of U.S. Treasury requirements concerning advances and immediate cash needs.
- 2.2:** Develop and implement policies and procedures to ensure that all disbursement requests from the accountable entity of the recipient countries follow the official format that documents the cash requirements for each month of the quarterly period.
- 2.3:** Make and document all payments to the recipient countries on a monthly basis instead of a quarterly basis.
- 2.4:** Establish and implement policies and procedures to ensure that any custodial liabilities, e.g. interest owed to the U.S. Government resulting from the grantee advances, are properly recorded.

Management Decision: MCC management accepts recommendations 2.2, 2.3 and 2.4. Regarding recommendation 2.1, MCC intends to follow sound cash management practices, will disburse funds consistent with GAO policy based on an evaluation of what is needed to meet grant purposes in any given quarter, though the funds will be released in tranches following a monthly schedule.

MCC has begun implementing needed corrective actions. The MCC FMPP manual (currently being developed – see above management response to recommendation 1) will contain definitive documentation and disbursement requirements for transferring funds to compact countries. Furthermore, the Division of Finance, in coordination with the National Business Center (MCC's financial services provider) has already implemented procedures to

disburse funds to compact countries monthly in accordance with identified funding needs per pertinent quarterly disbursement requests.

* * * * *

Material Weakness 3: MCC does not have a property management system.

Recommendation 3: Williams, Adley & Company recommends that MCC develop and maintain appropriate fixed asset records to ensure accurate reporting and physical control.

Management Decision: MCC management accepts the recommendation. The Department of Administration and Finance has begun planning and defining requirements for implementing a viable property management system and associated controls and processes, including periodic physical counts to verify the Corporation's property holdings and ensure the propriety of perpetual property records and related financial balances.

* * * * *

Material Weakness 4: MCC did not properly record compact expenses during the fiscal year.

Recommendations: Williams, Adley & Company recommends that MCC management:

- 4.1: Require that the final quarterly disbursement requests received from the accountable entity of the recipient countries be made available to the Department of Administration and Finance and the Fiscal Accountability Office.
- 4.2: Develop and implement policies and procedures that require compact expenses are properly and accurately recorded and reported on a quarterly basis.
- 4.3: Implement written procedures requiring that appropriate and timely follow-up actions are performed and documented on late and/or outstanding fund disbursements and/or advance requests.
- 4.4: Develop and implement policies and procedures that require the Department of Administration and Finance to perform a thorough review of the financial statements to ensure that costs are not omitted.

Management Decision: MCC management accepts the recommendations. The Division of Finance has already implemented quality assurance and review procedures to help ensure that compact disbursement requests/reports, which are to include compact expense information, are received timely, are complete, and that relevant financial information from such requests are properly included in quarterly financial statements and reports prepared by NBC. In the event of missing or late reports/requests, Division of Finance personnel will contact the pertinent accountable officials to obtain the reports/requests, and document such. Relevant policies and procedures will be included in the FMPP manual.

* * * * *

Material Weakness 5: MCC's Chief Financial Officer was not an integral part of the compact/grant processes.

Recommendation 5: Williams, Adley & Company recommends that MCC management revise its policies and procedures to invest the Office of the Chief Financial Officer (CFO) with the level of responsibility, including role and all levels of authority established by the Chief Financial Officers Act.

Management Decision: MCC management accepts the recommendation and will take the necessary steps to establish and implement required policies, procedures and organizational protocol to ensure that the Corporation's CFO is appropriately involved with financial management operations entity-wide.

* * * * *

Reportable Condition 1: MCC's travel disbursement controls and procedures do not permit the effective and efficient management of travel.

Recommendation 6: Williams, Adley & Company recommends that MCC management develop and implement controls to reject travel expense reimbursement requests that exceed the allowable country per diem limits unless additional electronic authorization is provided.

Management Decision: MCC management accepts the recommendation. The Deputy Chief Financial Officer has instructed the Division of Finance staff not to approve any claimed travel expenses that exceed established limitations as defined by the Federal Travel Regulation (FTR). Furthermore, the Division has instituted procedures to require that a traveler's responsible manager/supervisor be apprised of claimed expenses that are not in compliance with FTR and/or MCC requirements, and that the manager/supervisor explicitly approve such expenses, but only if allowable per the FTR.

* * * * *

Material Noncompliance 1: MCC did not fully comply with the Federal Financial Management Improvement Act (FFMIA) and the Government Performance and Results Act (GPRA).

Recommendations: Williams, Adley & Company recommends that MCC management:

7.1: Develop performance goal templates and follow-up training to ensure that Government Performance and Results Act (GPRA) requirements are adequately addressed and consistent. Williams, Adley & Company and the OIG also recommend that baseline data be finalized or performance indicators reviewed and amended such that they can be measured against obtainable data.

7.2: Assess the automated options available to handle MCC operations and develop short-range and long-range plans for implementation of the most appropriate information technology structure to address electronic integration of at least the payroll, procurement

and travel functions and systems to increase the efficiencies and effectiveness of the processing of financial transactions; and decrease the risk of errors.

Management Decision: MCC accepts the recommendations. Relative to GPRA, Department of Administration and Finance management is working with the various corporate organizations to help ensure that strategic and operational performance goals, including financial management performance, and inter-related and resulting performance data is reliable and consistent.

In regard to systems electronic integration, Department of Administration and Finance management is currently considering various potential options and alternatives for increasing the electronic integration, responsiveness and efficiency of the financial management systems used by the Corporation. The Division of Finance is working with NBC to identify potential automation opportunities for various financial management systems functions, including enhanced automated financial reporting and cost accumulation. Since MCC outsources its financial management and administrative functions, the Corporation is highly dependent upon its financial and administrative services provider (NBC) to help ensure operation of effective financial systems.

* * * * *

Material Noncompliance 2: MCC does not comply with the Federal Information Security Management Act (FISMA). Williams, Adley & Company makes no recommendation(s) relative to this material noncompliance since the deficiency was identified by the Office of Inspector General in a prior audit and MCC management has:

- acknowledged that it has not fully met FISMA requirements;
- hired an outside expert to perform an independent security audit; and
- proposed a timetable for compliance.

**Millennium Challenge Corporation
Statements of Financial Position
As of September 30, 2006 With Summary Totals for 2005**

	2006 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Assets								
Current Assets								
Fund Balance with Treasury (Note 2)	\$ 3,931,404,782	\$ 3,610,671,774	\$ 55,951,660	\$ 193,230,000	\$ 32,200,504	\$ 37,567,478	\$ 1,783,336	\$ 2,356,547,000
Receivables/Advances/Prepayments (Note 3)	18,893,478	16,587,951	511,426	-	1,731,899	62,202	-	4,338,698
Fixed Assets								
Leasehold Improvements and Capital Equipment (Note 4)	4,632,785	-	-	-	-	4,632,785	-	4,244,059
Total Assets	<u>\$ 3,954,931,015</u>	<u>\$ 3,627,259,725</u>	<u>\$ 56,463,086</u>	<u>\$ 193,230,000</u>	<u>\$ 33,932,403</u>	<u>\$ 42,262,465</u>	<u>\$ 1,783,336</u>	<u>\$ 2,367,129,757</u>
Liabilities								
Accounts Payable	2,552,277	-	774,246	-	731,258	1,046,773	-	1,319,467
Other Liabilities (Note 5)	2,516,786	-	-	-	(461,774)	2,978,560	-	2,522,803
Accrued Funded Annual Leave	2,698,070	-	-	-	-	2,698,070	-	1,386,644
Total Liabilities	<u>\$ 7,767,133</u>	<u>\$ -</u>	<u>\$ 774,246</u>	<u>\$ -</u>	<u>\$ 269,484</u>	<u>\$ 6,723,403</u>	<u>\$ -</u>	<u>\$ 5,228,914</u>
Net Position								
Unexpended Appropriations	1,283,003,488	1,187,867,694	43,098,943	0	23,298,780	26,954,705	1,783,336	349,153,392
Obligated	856,804,162	842,399,600	5,052,595	0	8,495,391	856,576	0	606,634,745
Commitments	1,802,661,275	1,596,992,431	7,537,302	193,230,000	1,868,748	3,032,794	-	1,401,835,873
Alignments - Realized Resources	4,694,987	-	-	-	-	4,694,987	-	4,276,883
Cumulative Results of Operations	3,947,163,882	\$ 3,627,259,725	\$ 55,688,840	\$ 193,230,000	\$ 33,662,919	\$ 35,539,082	\$ 1,783,336	\$ 2,361,900,843
Total Net Position (Note 6)	<u>\$ 3,954,931,015</u>	<u>\$ 3,627,259,725</u>	<u>\$ 56,463,086</u>	<u>\$ 193,230,000</u>	<u>\$ 33,932,403</u>	<u>\$ 42,262,465</u>	<u>\$ 1,783,336</u>	<u>\$ 2,367,129,757</u>
Total Liabilities and Net Position								
	<u>\$ 3,954,931,015</u>	<u>\$ 3,627,259,725</u>	<u>\$ 56,463,086</u>	<u>\$ 193,230,000</u>	<u>\$ 33,932,403</u>	<u>\$ 42,262,465</u>	<u>\$ 1,783,336</u>	<u>\$ 2,367,129,757</u>

The notes are an integral part of these financial statements

**Millennium Challenge Corporation
Statements of Operations and Changes in Net Position
For the Year Ended September 30, 2006 With Summary Totals for 2005**

	2006 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Financing Sources								
Appropriations Used	\$ 92,455,115	\$ 16,747,194	\$ 5,885,167	\$ -	\$ 15,137,340	\$ 54,055,700	\$ 619,714	\$ 39,312,758
Expenses	92,036,960	16,747,194	5,885,167	-	15,137,340	53,637,545	619,714	35,035,926
Excess of Financing Sources over Expenses	\$ 418,155	\$ -	\$ (0)	\$ -	\$ 0	\$ 418,155	\$ -	\$ 4,276,832
Net Position								
Excess of Financing Sources over Expenses	418,155	-	(0)	-	0	418,155	-	4,276,832
Increase in Unexpended Appropriations								
Appropriated								
Obligated	933,850,067	863,789,695	36,954,637	-	14,498,520	17,054,929	1,552,286	346,388,202
Commitments	856,804,162	842,399,600	5,052,595	0	8,495,391	856,576	0	626,634,744
Allotments - Realized Resources	(168,109,344)	(358,233,833)	(8,007,053)	193,230,000	1,868,748	3,032,794	-	407,664,296
Transfers In/(Out)	(20,000,000)	-	-	(20,000,000)	-	-	-	-
Permanent Recession	(17,700,000)	(17,700,000)	-	-	-	-	-	(12,000,000)
Total Increase in Unexpended Appropriations	1,585,263,040	1,330,255,462	34,000,179	173,230,000	24,862,659	21,362,454	1,552,286	1,372,964,074
Beginning Net Position	2,361,900,842	2,297,004,263	21,688,661	20,000,000	8,800,260	14,176,608	231,050	988,936,768
Ending Net Position	\$ 3,947,163,882	\$ 3,627,259,725	\$ 55,688,840	\$ 193,230,000	\$ 33,662,919	\$ 35,539,062	\$ 1,783,336	\$ 2,361,900,842

The footnotes are an integral part of these financial statements

**Millennium Challenge Corporation
Statements of Functional Expenses
For the Year Ended September 30, 2006 With Summary Totals for 2005**

	2006 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Salary and Benefits	\$27,587,426	\$ -	\$ -	\$ -	\$ -	\$ 27,587,426	\$ -	\$ 13,343,440
Travel	6,362,880	-	-	-	317,509	6,045,371	-	3,980,087
Rent/Lease	4,404,013	-	-	-	-	4,404,013	-	718,546
Utilities	766,206	-	-	-	-	766,206	-	207,704
Information Technology Services	2,562,575	-	-	-	-	2,562,575	-	2,065,657
Accounting Services	4,244,677	-	-	-	-	3,624,963	619,714	3,166,484
Interagency Agreements	4,636,977	-	-	-	4,636,977	-	-	564,654
Other Services	13,563,769	-	-	-	9,755,703	3,808,066	-	6,082,697
Supplies and Equipment	2,211,918	-	-	-	-	2,211,918	-	2,671,882
Grants	22,642,361	16,747,194	5,895,167	-	-	-	-	1,024,133
Miscellaneous	3,054,158	-	-	-	427,151	2,627,007	-	1,190,642
Total Expenses	\$ 92,036,960	\$ 16,747,194	\$ 5,895,167	\$ -	\$ 15,137,340	\$ 53,637,545	\$ 619,714	\$ 35,035,926

The footnotes are an integral part of these financial statements

**Millennium Challenge Corporation
Statements of Cash Flows
For the Year Ended September 30, 2006 With Summary Totals for 2005**

	2006 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Cash Flows from Operating Activities								
Excess of Financing Sources over Expenses	\$ 418,155	\$ -	\$ -	\$ -	\$ -	\$ 418,155	\$ -	\$ 4,276,832
Adjustments Affecting Cash Flow:								
Depreciation Expense	483,000					483,000		
Changes in Assets and Liabilities:								
Appropriated Capital Used	(92,455,115)	(16,747,194)	(5,895,167)	-	(15,137,340)	(54,055,700)	(619,714)	(39,312,758)
Increase in Advances/Receivables/Prepayments	(14,554,780)	(14,782,027)	(511,426)	-	768,101	(29,428)	-	(4,170,099)
Increase in Accounts Payable	1,232,809	-	774,246	-	659,128	(200,565)	-	1,295,584
Decrease in Other Liabilities	(6,017)	-	(154,526)	-	(1,459,696)	2,059,014	(450,809)	1,668,178
Increase in Annual-funded Leave Liabilities	1,311,427	-	-	-	-	1,311,427	-	1,216,743
Total Adjustments	(103,988,676)	(31,529,221)	(5,786,873)	-	(15,169,807)	(50,432,252)	(1,070,523)	(39,302,352)
Net Cash Used in Operating Activities	\$ (103,570,521)	\$ (31,529,221)	\$ (5,786,873)	\$ -	\$ (15,169,807)	\$ (50,014,097)	\$ (1,070,523)	\$ (35,025,520)
Cash Flows from Investing Activities								
Purchase of Property	\$ (871,727)	\$ -	\$ -	\$ -	\$ -	\$ (871,727)	\$ -	\$ (4,244,059)
Net Cash Used in Investing Activities	\$ (871,727)	\$ -	\$ -	\$ -	\$ -	\$ (871,727)	\$ -	\$ (4,244,059)
Cash Flows from Financing Activities								
Appropriations received net of rescissions	\$ 1,752,300,000	\$ 1,347,002,655	\$ 39,895,345	\$ 248,230,000	\$ 40,000,000	\$ 75,000,000	\$ 2,172,000	\$ 1,488,000,000
Transfers Out	(75,000,000)	-	-	(75,000,000)	-	-	-	(80,000,000)
Net Cash Provided by Financing Activities	1,677,300,000	1,347,002,655	39,895,345	173,230,000	40,000,000	75,000,000	2,172,000	1,408,000,000
Net Increase in Cash	1,572,857,752	1,315,473,434	34,108,472	173,230,000	24,830,193	24,114,176	1,101,477	1,388,730,421
Fund Balance with Treasury, Beginning	2,358,547,000	2,295,198,340	21,843,188	20,000,000	7,370,311	13,453,302	681,859	989,816,579
Fund Balance with Treasury, Ending	\$ 3,931,404,752	\$ 3,610,671,774	\$ 55,951,660	\$ 193,230,000	\$ 32,200,504	\$ 37,567,478	\$ 1,783,336	\$ 2,358,547,000

The footnotes are an integral part of these financial statements

**Millennium Challenge Corporation
Statements of Budgetary Resources
For the Year Ended September 30, 2006 With Summary Totals for 2005**

	2006 Total	Contracts	Pre-Contract Funding	Threshold	Evaluation and Support	Administrative	Audit	2005 Total
Budgetary Resources:								
Budget Authority:								
Appropriations	1,770,000,000	1,364,702,655	39,895,345	248,230,000	40,000,000	75,000,000	2,172,000	1,500,000,000
Net Transfer, Current Year Authority								
Unobligated Balance - Beginning of Period	2,053,722,184	1,972,926,264	15,544,354	65,251,566				986,171,577
Unobligated Balance - Transferred								
Spending Authority from Offsetting Collections	-							
Advances Received	-							
Adjustments:								
Recoveries of Prior Years Obligations	(17,700,000)	(17,700,000)						(12,000,000)
Permanently Not Available (Note 7)	\$ 3,806,022,184	\$ 3,319,928,919	\$ 55,439,699	\$ 313,481,566	\$ 40,000,000	\$ 75,000,000	\$ 2,172,000	\$ 2,474,171,577
Total Budgetary Resources								
Obligations Incurred	\$ 1,109,535,594	\$ 880,536,888	\$ 42,849,803	\$ 83,230,412	\$ 29,635,861	\$ 71,110,630	\$ 2,172,000	\$ 420,449,393
Unobligated Balance Available:								
Appropriated	877,383,424	842,389,600	10,644,896	10,085,419	10,364,139	3,889,370	-	683,006,839
Unobligated Balance Not Available:	1,819,103,166	1,596,992,431	1,945,000	220,165,735				1,370,715,345
Total Status of Budgetary Resources	\$ 3,806,022,184	\$ 3,319,928,919	\$ 55,439,699	\$ 313,481,566	\$ 40,000,000	\$ 75,000,000	\$ 2,172,000	\$ 2,474,171,577
Relationship of Obligations to Outlays:								
Obligated Balance, Net - as of October 1, 2005	\$ 384,862,005	\$ 322,272,076	\$ 6,298,834	\$ 34,699,991	\$ 7,370,311	\$ 13,538,935	\$ 681,859	\$ 3,645,002
Obligations Incurred	1,109,535,594	880,536,888	42,849,803	83,230,412	29,635,861	71,110,630	2,172,000	420,449,393
Recoveries of Prior Years Obligations	-							
Adjustments	(8,881,212)	0	(774,246)	0	(1,670,526)	(6,436,440)	0	(5,335,889)
Obligated Balance, Net - End of Period	(1,376,397,315)	(1,171,279,742)	(42,587,517)	(112,225,132)	(21,566,882)	(26,954,705)	(1,783,336)	(379,526,106)
Accounts Payable	\$ 109,119,072	\$ 31,529,222	\$ 5,786,873	\$ 5,705,271	\$ 13,768,764	\$ 51,258,420	\$ 1,070,523	\$ 39,232,390
Total Outlays								
Outlays:								
Disbursements	109,119,072	31,529,222	5,786,873	5,705,271	13,768,764	51,258,420	1,070,523	39,232,390
Collections / Refunds	-	-	-	-	-	-	-	-
Net Outlays	\$ 109,119,072	\$ 31,529,222	\$ 5,786,873	\$ 5,705,271	\$ 13,768,764	\$ 51,258,420	\$ 1,070,523	\$ 39,232,390

The footnotes are an integral part of these financial statements

NOTES TO FINANCIAL STATEMENTS (AS OF SEPTEMBER 30, 2006)

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, cash flows, and budgetary resources for MCC (the Corporation), as required by Section 613 of the Millennium Challenge Act of 2003 and the Government Corporation Control Act (31 U.S.C. §9106). These financial statements have been prepared from the books and records of the Corporation 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.

The Corporation's accounting policies conform to and are consistent with generally accepted accounting principles for the Federal government, as promulgated by OMB and prescribed by the Federal Accounting Standards Advisory Board (FASAB).

The Corporation's principal financial statements are:

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

MCC has presented comprehensive statements for fiscal year 2006, with summary totals for 2005 for comparative purposes. These notes are considered an integral part of the financial statements.

B. Reporting Entity

The Corporation was formed in January 2004 pursuant to the Millennium Challenge Act of 2003 (Public Law 108-199). The Corporation's mission is to provide United States assistance to eligible countries for global development. The assistance is intended to provide economic growth and the elimination of extreme poverty, strengthen good governance, encourage economic freedom, and promote investments in people.

C. Budgets and Budgetary Accounting

The Corporation's programs and activities are funded through no-year appropriations. Such funds are available for obligation without fiscal year limitation and remain

available until expended. MCC was provided total appropriations of almost \$1.8 billion and \$1.5 billion in FY 2006 and FY 2005, respectively. OMB apportions MCC administrative funds on an annual basis pursuant to statutory limitations in the appropriations bill. In addition, MCC receives from OMB a separate apportionment for due diligence funds, which MCC uses for compact evaluations and support, compact programs, 609(g) funds, the Threshold Program, and audit funds. Because of the no-year status of MCC appropriations, unobligated administrative, audit and due diligence funds (apportioned on annual bases) are not returned to Treasury. MCC's policy is to transfer any unobligated balances as of September 30, for these three categories of funds to compact funds at the beginning of the subsequent fiscal year.

D. Basis of Accounting

Financial transactions are recorded on accrual and budgetary bases in accordance with pertinent Federal accounting and financial reporting requirements. Under the accrual method of accounting, financing sources are recognized when used and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates the Corporation's compliance with legal constraints and controls over the use of Federal funds.

The accompanying Statements of Financial Position, Operations and Changes in Net Position, Cash Flows, and Functional Expenses have been prepared on the accrual basis. The Statement of Budgetary Resources has been prepared in accordance with budgetary accounting rules. The Statement of Cash Flows has been prepared to reconcile budgetary to financial (proprietary) accounting information.

E. Fund Balance with Treasury

The Corporation does not maintain cash in commercial bank accounts. Rather, the Corporation's funds are maintained in Treasury accounts. The Department of the Treasury processes all cash receipts and disbursements for the Corporation. 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. Advances to Others

The Corporation advances funds in response to compact countries and Federal agency drawdown requests in order to implement compact projects in an MCA country or inter-agency agreements. Funds advanced to compact countries are used to pay legitimate costs and expenses incurred per the formal compacts entered into by MCC and the countries.

G. Property and Equipment

The Corporation's accounting policies require that property and equipment with original cost of \$25,000 or more and an estimated useful life of two or more years to be capitalized. Such assets include leasehold improvements, telephone equipment, computer systems equipment, copiers, computer software, furniture, and assets under capital leases. The assets are to be depreciated (or amortized) over their estimated useful lives.

H. Compacts and Pre-Compact (609(g))Funding Payable

Compact funding, including 609(g) funds, are made to eligible countries with approved Compact or pre-Compact funding agreements. Upon formally entering into a compact with a country, the Corporation records a commitment of funds (i.e., administrative reservation) in its financial records for the total value of the compact. Once a compact enters into force, the value of the compact is obligated on MCC's financial books (and the related commitment reduced/liquidated). At the end of the fiscal year, the Corporation records the total estimated amount of compact expenses incurred for work performed but not paid as liquidations of the advances. The estimated amount of such expenses at September 30, 2006 and September 30, 2005, were \$1.956 million and \$0, respectively.

I. Accounts Payable

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

J. Actuarial FECA Liability

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

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

The Corporation incurred no FECA liabilities during fiscal years 2006 and 2005.

K. Other Liabilities

Other liabilities include amounts owed, but not paid, at the end of the fiscal year for employee payroll and benefits and Federal Employees' Compensation Act charges (see Exhibit 13).

L. Accrued Annual Leave

The value of employees' unused annual leave at the end of the fiscal year is accrued as a liability. At the end of each fiscal year, the balance in the accrued annual leave account is adjusted to reflect current year pay rates and leave balances. Annual leave is funded from current appropriations. 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 leave.

M. Net Position

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

N. Financing Sources

Per note 1.C, the Corporation 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.

O. Retirement Benefits

The Corporation's employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). FERS was established by Public Law 99-335. Pursuant to this law, most employees hired after December 31, 1983 are covered by FERS and Social Security. 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, the Corporation contributes seven percent of their gross pay towards their retirement benefits. For those employees covered by FERS, the Corporation contributes 11 percent of their gross pay towards retirement. Employees are also allowed to participate in the Federal Thrift Savings Plan (TSP). For employees under FERS, the Corporation contributes an automatic one percent of basic pay to TSP and matches employee contributions up to an additional four percent

of pay, for a maximum Corporation contribution amounting to five percent of pay. Employees under CSRS may participate in the TSP, but will not receive either the Corporation's automatic or matching contributions.

During FY 2006, the Corporation made retirement contributions of \$761,000 to CSRS; \$1.977 million to FERS; and \$620,700 to TSP. In FY 2005 the Corporation made contributions of \$30,000 to CSRS, \$876,000 to FERS and \$226,000 to TSP.

P. Use of Estimates

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

Q. Contingencies

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

R. Judgment Fund

Certain legal matters to which the Corporation can be named as a party may be administered and, in some instances, litigated and paid by other Federal agencies. 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 Treasury, called the Judgment Fund. Although the ultimate disposition of any potential Judgment Fund proceedings cannot be determined, management does not expect any liability or expense that might ensue would be material to the Corporation's financial statements.

S. Custodial Receivables and Liabilities

Under current policy and procedures, the Corporation funds all Compacts with other countries by advancing funds to cover projected needs, generally for a forthcoming three-month period. 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 the Corporation and deposited into an account at the

U.S. Treasury. Such interest may not be retained or used by the Corporation, but periodically is returned to the Treasury's general funds. As of September 30, 2006, receivables for amounts of interest to be remitted by the countries and the related liabilities are not reflected in these financial statements. As of September 30, 2006, the Corporation had outstanding advances related to compact financing of approximately \$16.6 million. During FY 2006 the Corporation received and deposited \$304,000 in interest remittances. At the end of FY 2006, approximately \$174,000 of interest earned on compact advances to the MCAs was due to be remitted to MCC. At the end of FY 2005, the Corporation had advances of \$1.8 million and received interest remittances of approximately \$17,000 during the year.

Note 2—Fund Balance with Treasury

The U.S. Treasury accounts for all U.S. Government funds on an overall consolidated basis. The Fund Balance with Treasury line items on the Statements of Financial Position for FY 2006 and FY 2005 consisted of amounts presented in the following table.

**Fund Balances with Treasury
(in thousands)**

Appropriated Funds	2006	2005
Unobligated	\$ 2,546,127	\$ 1,973,685
Obligated	1,385,278	384,862
Total	\$ 3,931,405	\$ 2,358,547

Note 3—Advances/Accounts Receivable

Advances reflect amounts provided to MCA compact countries and other Federal agencies, in accordance with formal compacts or inter-agency agreements, respectively. Accounts receivable reflect overpayments of payroll and travel expenses to current employees of the Corporation. As such, no allowance for doubtful accounts is necessary. As of September 30, 2006, the Corporation reported \$18.9 million in advances and receivables, of which \$18.8 million related to advances for compact implementation and approximately \$62,000 for receivables.

Note 4—Fixed Assets

The Corporation's fixed (capital) assets are predominantly comprised of leasehold improvements related to the MCC headquarters offices located in Washington, DC. As of September 30, 2006, the Corporation reported \$5.1 million of which \$4.8 million represented leasehold improvements and \$280,000 represented capitalized

equipment. At the end of the fiscal year, \$483,000 of amortization and depreciation had been recorded for the two categories of assets.

Note 5—Other Liabilities

The Corporation is liable for amounts owed to other parties, including employees and other Federal groups. The following table presents the amounts of such liabilities as of September 30, 2006 and 2005.

**Other Liabilities
(in dollars)**

Type	2006	2005
Evaluation and Support	\$ (461,744)*	\$ 997,921
Travel	300,000	747,143
Office of the Inspector General	0	450,809
Miscellaneous	1,566,695	326,935
Payroll	1,111,865	0
Total	\$ 2,516,786	\$ 2,522,808

** This amount represents the difference in funds drawn from MCC's accounts by other Federal parties per inter-agency agreements (through the Department of the Treasury's Intra-governmental Payment and Collection System (IPAC)) and the liability amounts recorded by MCC. In short, as of September 30, 2006, other Federal entities had drawn approximately \$1.401 million from MCC's accounts with Treasury. MCC had recorded liabilities of \$.939 million for the pertinent charges—\$.462 million less than the amounts "drawn" by the entities. At the end of the fiscal year, MCC and its financial services provider (the Department of Interior's National Business Center) were researching the differences and reconciling supporting records.*

Note 6—Net Position

The reported net position consists of unexpended appropriations and cumulative results of operations, which reflects the difference between financing sources and expenses since the Corporation's inception.

The following table presents total obligated and unobligated compact and 609(g) funds as of September 30, 2006 and 2005.

Total Obligated and Unobligated Compact and 609(g) Funds (in dollars)

	2006	Compacts	609(g) Funding	2005
Obligations				
Armenia	\$ 235,646,177	\$ 235,150,000	\$ 49,000,000	
Benin	1,062,985		1,062,985	
Cape Verde	106,077,520	106,014,782	62,738	\$
Georgia	296,178,084	292,802,057	3,376,027	4,111,000
Ghana	13,584,891		13,584,891	48,688
Honduras	213,166,147	213,166,147		215,000,000
Lesotho	902,934		902,934	600,000
Madagascar	103,290,130	101,990,130	1,300,000	110,378,000
Mali	4,421,534		4,421,534	
Mozambique	12,956,078		12,956,078	
Nicaragua	173,583,320	173,529,975	53,345	
Senegal	4,882,237		4,882,237	
Vanuatu	65,214,603	65,214,603		
Total Obligations	\$ 1,230,966,637	\$ 1,187,867,694	\$ 43,098,999	\$ 330,222,308
Commitments				
Benin	\$ 305,781,621	\$ 305,761,550	\$	
Cape Verde	—			\$ 110,078,480
Georgia	—			295,300,000
Ghana	536,638,050	536,638,050		2,870,502
Mali	4,606,861		4,606,861	
Mozambique	—			6,000,000
Nicaragua	—			175,000,000
Senegal	425,658		425,658	6,528,299
Total Commitments	\$ 847,452,190	\$ 842,399,600	\$ 5,052	\$ 595,777,281

Note 7—Permanent Rescission

In FY 2006 and FY 2005, respectively, \$17.7 million and \$ 12 million of amounts previously appropriated under the FY 2006 and FY 2005 Foreign Operations, Export Financing, and Related Programs Appropriations Acts (Public Law 109-148 and Public Law 108-447, respectively), were rescinded. The rescissions were part of the Across-the-Board Rescissions enacted for FY 2006 and FY 2005, respectively.

Note 8—Inter-Agency Agreements

MCC is party to various inter-agency agreements (IAA) with other Federal agencies for services to be provided by those entities. Such services include financial, travel management and other administrative functions; technical and engineering services, personnel background records checks; and information technology services. During FY 2006, MCC executed 20 IAAs with other Federal agencies totaling almost \$9.1 million. At the end of the year, approximately \$6.8 million remained available for

paying future services to be provided under the subject IAAs. The following table provides a summary of the IAAs by Federal entity.

Fiscal Year 2006 Inter-agency Agreements

AGENCY	NUMBER OF IAAs	DOLLAR VALUE	REMAINING FUNDS – END OF FY
NBC, Dept. of Interior	6	\$1,216,313	\$ 0
State Dept.	4	437,668	242,160
U.S. Agency for International Development	1	140,000	140,000
Dept. of Agriculture	1	228,478	44,820
U.S. Army Corps of Engineers	3	5,441,379	5,004,390
Dept. of Transportation	1	109,083	83,794
Dept. of Health and Human Services	1	1,500,000	1,241,422
Dept. of Labor	1	2,912	0
Government Printing Office	1	3,000	3,000
Office of Personnel Management	<u>1</u>	<u>5,000</u>	<u>220</u>
Total	20	\$9,083,833	\$6,759,806

Endnotes

¹The Gambia was previously selected as compact–eligible but is currently suspended.

²Previously selected as a Threshold program country and has an approved and/or on-going Threshold program.

³Previously selected as a Threshold program country.

⁴Yemen was previously selected as a Threshold program country but is currently suspended. Because of ongoing reforms, Yemen has asked for reinstatement.

⁵Cape Verde was a low income country at the time of its compact's signing.

⁶ All beneficiary numbers or ranges of beneficiary numbers, except Armenia, are based on the MCC approved Monitoring and Evaluation Plans. Armenia's beneficiary numbers are based on the Investment Memo. Beneficiary totals do not distinguish between direct and/or indirect beneficiaries. Target populations are likely to benefit from multiple project interventions. Accordingly, it is inadvisable to sum total beneficiaries across projects as the likelihood of double-counting will overstate the actual number benefited.

(a) Cape Verde—Private Sector Development Project: Beneficiaries are to be determined in June–July 2007 after project identification by the International Finance Corporation.

(b) Ghana—Transportation Project: Due Diligence minimal estimates for the improvement of the N1 Highway.

(c) Ghana—Rural Development Project: Likely to underestimate the total number of beneficiaries; a) Support for Community Services is expected to benefit several tens of thousands of households, b) Strengthening of Public Sector Procurement Capacity is expected to indirectly benefit all those affected by government efficiency, c) Strengthening of Rural Financial Services is expected to indirectly benefit all rural banking customers.

(d) Honduras—Rural Development Project: Number likely underestimates the total number of beneficiaries as a) the number of program participants to obtain a loan, b) the number of liens registered, and c) the population benefiting from farm-to-market road upgrades has not yet been determined.

(e) Honduras—Transportation Project: Roads benefits are based on the direct benefits derived from reduced travel time, reduced vehicle operating costs and increased traffic use. Number of beneficiaries is undetermined. Annual traffic volume at end of five years is projected at 4.5 million vehicles.

(f) Madagascar—Land Tenure Project: Based on the total number of Land Offices (255) multiplied by the estimated average number of titles (800) to be issued by each Land Office by the end of Compact; assumes a one-to-one correspondence between land titles issued and beneficiaries.

(g) Madagascar—Finance Project: Indicator will measure number of savings accounts based on the difference between baseline numbers and end-of-Project targets disaggregated by Financial Source; i.e., National Savings Bank, the Central Bank, Commission de Supervision Bancaire et Financiere, and Micro-Finance Institutions.

(h) Mali—Airport Improvement Project: Beneficiary indicators, as opposed to a number of beneficiaries (individuals), include the total revenue of firms servicing the airport, real wage income of employees of firms servicing the airport, real wage income in the tourism industry, and total receipts of hotels and restaurants in the Bamako area.

(i) Mali—Industrial Park Project: Number likely underestimates the total number of beneficiaries as said number accounts only for jobs directly created by project activities. Total beneficiaries are people in Year 5 who have gained long-term employment in the firms located in the industrial park. Other beneficiary indicators include gross value-added of firms located in the industrial park and real wages of employees of companies in the industrial park.

(j) Mali—Alatona Irrigation Project: Number likely underestimates the total number of beneficiaries as said number accounts only for jobs directly

created by project activities. Number does not include those who will be affected by larger crop yields and/or lower cargo rates.

(k) Nicaragua—Property Regularization Project: Based on the total number of rural (21,000) and urban (22,000) parcels which will have a registered title; assumes a one-to-one correspondence between land titles issued and beneficiaries.

(l) Nicaragua—Transportation Project: Roads benefits are based on the direct benefits derived from reduced travel time, reduced vehicle operating costs and increased traffic use. Number of beneficiaries is undetermined. Annual average daily traffic volume at the end of five years for N1 is projected at 4,061 vehicles.

(m) Nicaragua—Rural Development Project Business: Number likely underestimates the total number of beneficiaries as said number refers to the number of jobs created at end of five years; does not include other indicators measuring number of program businesses (4,720), including farms, engaged in higher profit businesses at end of the Compact.

⁷ Net Investment in Projects excludes Program Administration and Control/Oversight, Monitoring and Evaluation, Procurement Agent, Fiscal Agent, and Audit budgets. Net Investment in Projects is based on the Multi-year Financial Plans of the approved Compact documents. Numbers expressed in USD.

⁸ Source: World Bank Gross National Income (GNI) Per Capita as the measure for “per capita income”. The World Bank Gross National Income (GNI) Per Capita is the same source data used to determine MCA eligibility. As of January 2007, World Bank data is not available for 2006. Accordingly, all listed “per capita” data are from 2005. In calculating Gross National Income (GNI—formerly referred to as GNP) and GNI per capita in US dollars, the World Bank uses the Atlas conversion factor in order to reduce the impact of exchange rate fluctuations in the cross-country comparison of national incomes. The Atlas conversion factor for any given year is the average of a country’s exchange rate (or alternative conversion factor) for that year and its average exchange rates for the two preceding years, adjusted for the difference between the rate of inflation in that country and that of the Euro

Zone, Japan, United Kingdom, and the United States, as of 2001. A country's inflation rate is measured by the change in its GDP deflator.

⁹ Values and percentages designate the projected increase in incomes, measured in terms of the corresponding indicator of income, that are assumed to result from given MCC interventions. *Source: Compact Annex III.*

¹⁰ Armenia—as measured by the change in real income from the sale of agricultural produce per household member as an index (2005 = 100); *Source: Compact Annex III.*

¹¹ Benin—as measured by the average revenue and consumption level per household in access to land and access to finance measured through the National Living Standards Measurement Survey; *Source: Compact Annex III Description of the Monitoring and Evaluation Plan.*

¹² Cape Verde—as measured by the total increase in annual income from a) the Watershed Management and Agricultural Support Project, b) the Roads and Bridges Activity, c) the Port Activity, d) the Financial Sector Reform Activity and e) the Partnership to Mobilize Investment Activity; *Source: Compact Annex III Description of the Monitoring and Evaluation Plan.* The increase in annual income is approximately 1.2 percent of annual GDP in Year 5 and 2.2 percent in Year 10, assuming a real GDP growth rate of 4 percent.

¹³ El Salvador—as measured by the average annual per capita income of Program beneficiaries in the Northern Zone; *Source: Compact Annex III Description of the Monitoring and Evaluation Plan.*

¹⁴ Georgia—as measured by the financial benefits derived from pipeline rehabilitation and GRDF and ADA enterprise development activities. Note: this measure underestimates the impact of MCC interventions in Georgia as it does not take into account investments in roads and infrastructure. *Source: Compact Annex III.*

¹⁵ Ghana—as measured by a) net income per household from growing yams, sorghum and groundnuts (as proxies of the most likely crops grown) (Northern Zone: Savelugu Nanton, Tolon Kumbungu, Tamale, West Mamprusi and Karaga), b) net income per household from growing maize, yams and cas-

sava (as proxies of the most likely crops grown) (Afram Basin Zone-East: Fanteakwa and Kwahu South), c) net income per household from growing maize, yams and cassava (as proxies of the most likely crops grown) (Afram Basin Zone-West: Ejura Sekyedumasi, Afram Plains, Sekyere East and Sekyere West), and d) net income per household from growing pineapples and vegetables (as proxies of the most likely crops grown) (Southern Zone: Gomoa, Awutu Efutu Senya, Akuapim South, Manya Krobo, Dangme West, Yilo Krobo, North Dayi, Hohoe, Ketu, Keta, South Tongu and Akatsi).
Source: Compact Annex III.

¹⁶ Honduras—as measured by the increase in income of beneficiaries of the Rural Development and Transportation Projects; *Source: Compact Annex III Description of the Monitoring and Evaluation Plan.*

¹⁷ Madagascar—as measured by the National Statistical Institute’s National Household Income Survey that will enable the comparison of the intervention zones with similar non-intervention zones; *Source: Compact Annex III Description of the Monitoring and Evaluation Plan.*

¹⁸ Mali—as measured by a) the total receipts of commercial concessions, flight kitchens, fuel suppliers, and baggage handling servicing the Bamako-Senou Airport, b) total receipts of hotels and restaurants in Bamako, c) gross value-added of firms as well as total earnings including salaries and taxes of firms located in the industrial park, d) real income from irrigated agricultural production, e) real annual income from sale of agricultural production per household member in the Alaton zone. Data to be disaggregated by current residents and newly settled population to track whether resettled population’s incomes are restored as compared to their baseline incomes; *Source: Compact Annex III Description of the Monitoring and Evaluation Plan.*

¹⁹ Nicaragua—as measured by the sum of the expected income gains from a) savings due to reduced vehicle operating costs and travel time, b) increased property value per property times the number of properties registered, c) the increase in value added to project firms, employees of project farmers and businesses as well as employees of businesses in value chain. Total income gains include: a) N-1 Road Upgrade equal to US\$5.7million, b) Secondary

Roads equal to US\$8.6 million, c) Property Regulation equal to US\$3.9 million, d) Rural Business Development is Post-Compact and, therefore equal to US\$0 and e) Rural Business Development equal to US\$2.7 million; *Source: Compact Annex III Description of the Monitoring and Evaluation Plan.*

²⁰ Vanuatu—as measured by the average cash income per capita of residents living within the catchments areas of the infrastructure sub-projects); *Source: Compact Annex III Description of the Monitoring and Evaluation Plan.*

²¹ Projected increases in incomes are measured in terms of the corresponding country-specific income indicator.



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