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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, 2005 AND THE NINE MONTH PERIOD ENDING SEPTEMBER 30, 2004

AUDIT REPORT NO. M-000-06-001-C
December 6, 2005

WASHINGTON, DC

Office of Inspector General
for the
Millennium Challenge Corporation

December 6, 2005

MEMORANDUM

TO: John J. Danilovich, Chief Executive Officer, Millennium Challenge Corporation

FROM: John M. Phee, AIG/MCC /s/

SUBJECT: Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2005 and the Nine Month Period Ending September 30, 2004 (Report No. M-000-06-001-C)

Enclosed is the final report on the subject audit. The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of Williams, Adley and Company, LLP to audit the financial statements of the Millennium Challenge Corporation (MCC) for the period ending September 30, 2005 and the nine month period ended September 30, 2004. The contract required that the audit be performed in accordance with generally accepted auditing standards and Office of Management and Budget (OMB) Bulletin 01-02, Audit Requirements for Federal Financial Statements.

In its audit of the Millennium Challenge Corporation's (MCC) financial statements for the period ending September 30, 2005 and the nine month period ended September 30, 2004, the WA & Co. auditors found that:

- the financial statements were fairly presented in conformity with U.S. generally accepted accounting principles,
- four reportable conditions regarding the controls over financial reporting and its operations. One of the four reportable conditions is a material weakness, and
- three instances of noncompliance with laws and regulations. Two of the three instances of noncompliance were related to its financial and accounting system.

The material weakness and the reportable conditions identified in MCC's internal controls relate to Millennium Challenge Corporation's need to develop written policies and procedures to streamline its financial operations. Because of this material weakness and the reportable conditions, there is an increased risk of improper recording, unauthorized transactions, omissions, potential funds control violations and noncompliance with laws and regulations. Williams, Adley and Company, LLP reported the following internal control weaknesses:

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

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

3. MCC's Policies for Disbursing Advances to Grantees Do Not Accommodate Effective Cash Management Nor the Appropriate Recording of Custodial Interest Receivable and Payable (reportable condition and noncompliance)

4. MCC's Human Resources Responsible for Managing Its Financial Operations are Inadequate (reportable condition)

Williams, Adley and Company, LLP also reported the following 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), disclosed 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. 01-02, Audit Requirements for Federal Financial Statements:

1. MCC did not fully comply with Federal Financial Management Improvement Act (FFMIA) and 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 Does Not Accommodate Effective Cash Management Nor the Appropriate Recording of Custodial Interest Receivable and Payable (reportable condition and noncompliance)

In carrying out its oversight responsibilities, the OIG reviewed Williams, Adley and Company, LLP report and related audit documentation. This review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable the OIG to express, and we do not express, opinions on MCC's financial statements or internal control; on whether MCC's financial management systems substantially complied with FFMIA; or on MCC's compliance with other laws and regulations. Williams, Adley and Company, LLP is responsible for the attached auditors' report, dated November 7, 2005, and the conclusions expressed in the report. However, our review disclosed no instances where

Williams, Adley and Company, LLP did not comply, in all material respects, with applicable standards.

Because of the internal control weaknesses and the noncompliance finding reported by Williams, Adley and Company, LLP we are making the following recommendations to MCC's management:

Recommendation No. 1: We recommend that MCC's Office of Finance and Administration revise and reissue written policies and procedures that provide additional specificity including the Fund Balance with Treasury, financial reporting, payroll processing, accrual generation and reporting, interagency reporting, fixed assets, travel, monitoring and internal grant processes.

Recommendation No. 2: We recommend that MCC management:

2.1 Develop and disseminate to its staff explicit policies to ensure that its employees are aware of and follow the Federal Travel Regulations. The policies should require that any exceptions to the policies be documented and approved by a manager/supervisor in writing.

2.2 Institute policies and procedures to ensure proper authorizations and approvals are obtained and coordination with the Office of Finance and Administration has occurred for each planned trip prior to travel to ensure that the information is properly captured in the financial management system.

2.3 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.

Recommendation No. 3: We recommend that MCC management:

3.1 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.

3.2 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.

Recommendation No. 4: We recommend that MCC evaluate and document the need for additional employees in its Office of Finance and Administration to ensure that proper internal controls are in place to meet the agency's objectives. Additionally, the roles and responsibilities of the current Controller position and the new positions in the Office of Finance and Administration should be clearly delineated and communicated to its staff.

Recommendation No. 5: We recommend that MCC management:

5.1 a) Complete the development of a strategic plan for the next 6 fiscal years that meets OMB requirements, b) Involve MCC staff in the determination of corporate performance goals, and c) Establish and communicate operational performance goals for FY 2006 that align with the defined strategic goals and submit the operational goals to the Board and OMB.

5.2 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 your response to the draft report and the recommendations included therein. Based on your response to our recommendations, we consider that management decision has been reached on Recommendations No. 1, 2, 4, and 5. However, management decision has not been reached on Recommendation No. 3. According to your response you will study the action recommended by recommendation No. 3 and will provide us the results of that study within 30 days. Please forward to us all information related to your management decision on recommendation No. 3 and the final actions you have taken to implement the other recommendations. See the Exhibit for the full text of MCC's Management Comments.

The OIG appreciates the cooperation and courtesies extended to our staff and to the staff of Williams, Adley and Company, LLP during the audit. Please contact Alvin A. Brown at (202) 712-1003, if you have any questions concerning this report.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

On January 23, 2004, the United States established the Millennium Challenge Account (MCA), an innovative new foreign assistance program designed to reduce extreme poverty by promoting sustainable economic growth. The MCA grew out of the U.S. commitment at the Monterrey Summit on Financing for Development, as President Bush said, "to provide greater resources for developing countries taking greater responsibility for their own development." The Millennium Challenge Corporation (MCC) is a government corporation that was established to administer the MCA. Congress has provided MCC significant levels of funding to implement this new initiative.

Mission: MCC's mission is to reduce poverty by supporting sustainable, transformative economic growth in developing countries which create and maintain sound policy environments.

In the 21 months since its creation, MCC has laid the underpinnings of programs to address and implement the purposes of The Millennium Challenge Act of 2003, "*To provide assistance "in a manner that promotes economic growth and the alleviation of extreme poverty and strengthens good governance, economic freedom, and investments in people."* Accordingly, MCC is focused on this long-term, targeted foreign policy mission, and occupies a very vital and innovative niche in the U.S. government's overall foreign assistance program.

MCC's Organization

MCC is governed by a Board of Directors composed of the Secretary of State, the Secretary of the Treasury, the U.S. Trade Representative, the Administrator of the United States Agency for International Development (USAID), the CEO of MCC, and four public members[1] appointed by the President and confirmed by the Senate. The Secretary of State is the Chair of the Board and the Secretary of Treasury is the Vice Chair. MCC is managed by a Chief Executive Officer appointed by the President and confirmed by the Senate.

MCC is designed to make maximum use of flexible authorities to optimize efficiency in contracting, program implementation, and personnel. MCC is committed to hiring and retaining a small but highly talented workforce from diverse backgrounds.

MCC organizes its work into the following areas:

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

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[1] Two public members, Kenneth Hackett, President of Catholic Relief Services, and former Governor Christine Todd Whitman, who previously served as Administrator of the Environment Protection Agency, were confirmed by the Senate in July 2004. The other two public Board member positions remain open.

Country Programs manage MCC's relationship with eligible countries through all phases of the MCA.

Markets and Sector Assessments provide technical expertise on specific development function areas, such as infrastructure, agriculture, and financial sectors, as well as conducting assessments related to environmental compliance and fiscal accountability.

Monitoring and Evaluation oversees the assessment of economic logic, growth and poverty reduction impact of country proposals and programs, the establishment of monitoring and evaluation plans, and the collection and analysis of performance measurement data.

Administration and Finance
A&F is responsible for planning and directing all activities related to financial management and budgeting; human resources management; information technology infrastructure, resources and management; procurement and acquisition; security; facilities management; administrative services; and corporate records management.

Development Policy (DP)[2] is responsible for identifying policy issues, analyzing alternative approaches and recommending strategies for the most effective execution of MCC's mission. DP also manages the selection process and the policy indicators used to evaluate countries' policy performance.

Domestic Relations (DR): DR is responsible for managing MCC's relationship with Congress, key Executive departments and the press, working on issues relevant to MCC and other constituencies key to MCC's mission.

International Relations (IR): IR oversees MCC relations with other donors and multilateral organizations. It coordinates MCC positions on international development initiatives, recommends activities and policies to advance USG and MCC interests, and represents MCC at meetings regarding multilateral and donor issues.

Office of General Counsel (OGC): OGC is responsible for providing advice to MCC's Board of Directors and MCC staff on all legal issues affecting MCC.

PERFORMANCE GOALS, OBJECTIVES AND RESULTS FOR FY 2005

Although MCC has been driven by a very clearly articulated Mission statement since its creation, a formal strategy has not yet been published at the end of fiscal year 2005[3]. As more fully described in Material Weakness #1 below, MCC did not have detailed performance goals for fiscal year 2005. Clear operational objectives were set for calendar 2005 as detailed below. Actual accomplishments for fiscal year 2005 are presented below

[2] The offices of Development Policy and International Relations were consolidated in October 2005.

[3] A draft strategic plan was submitted to MCC’s Board in October 2005.

for information. MCC has developed a detailed strategic plan and is developing measurable performance goals linked to that plan that will be issued in early fiscal year 2006.

OBJECTIVE: Improve Program Operations	
Performance Targets (for calendar 2005):	**Accomplishments (for fiscal 2005):**
▪ Finalize board approval for 7 – 9 quality compacts and conclude steps necessary to initiate 3 Section 609(g) grants to countries with whom compacts will not have been signed in 2005, with an aggregate of 10 – 12 grants to countries;	▪ 5 Compacts approved by Board; ▪ 4 Section 609(g) actions approved by Board with countries with which compacts were not signed.
▪ Set up implementation systems, resident mission plans, and begin implementation in 4 – 6 Compact countries;	▪ Implementation systems initiated and resident missions established in 2 Compact countries.
▪ Finalize Board approval for 7 – 9 Threshold Programs and begin implementation on 6 – 8 Threshold Programs;	▪ 2 Threshold Programs approved by Board; ▪ 1 Threshold Program began implementation.
▪ Complete 2006 MCA-eligible & Threshold country selection, including improvements in selection criteria.	▪ Pending Board approval in November 2005.

▪ OBJECTIVE: **Organizational Capacity and Maturity**	
Performance Targets:	**Accomplishments:**
▪ Complete staffing plan matched to desired organizational capacity, with retention rate at 90 – 95%.	▪ Staff built to 147, slightly behind plans, with retention rate exceeding 90%.
▪ Complete essential policy papers and improved guidance to countries.	▪ Critical policy papers and guidance to countries published.

▪ Develop effective internal control environment, documentation and implementation of internal controls and systems.	▪ Initial set of internal controls put in place.
▪ Implement strategic performance assessment and compensation plan.	▪ First stage performance assessment and compensation plans in place.

▪ **Effective Communications and Constituency Relations**	
Performance Targets:	**Accomplishments:**
▪ Implement communications plan.	▪ Not yet accomplished.
▪ Implement Congressional outreach plan.	▪ Congressional outreach begun.
▪ Provide input into reauthorization bill.	▪ Completed; final action pending Congressional action.
▪ Submit Congressional Budget Justification for FY 2006.	▪ Submitted and pending Congressional action.

ALIGNMENT WITH THE PRESIDENT'S MANAGEMENT AGENDA

MCC significantly advanced its alignment with The President's Management Agenda, as follows:

- Strategic Management of Human Capital: MCC has made extensive and continuing use of the flexibilities in place to acquire and retain talent and leadership, and has maximized the number of staff in front-line program positions.

- Competitive Sourcing: MCC has consistently competed services eligible for such competition with both private and federal government suppliers, outsourcing a considerable part of both its program and support activities.

- Improved Financial Performance: MCC has meet expectations for timely and accurate reporting, with timely, unqualified audit opinions for both years of its existence.

- Expanded Electronic Government: MCC has used web-based technologies to enhance transparency of its operations, both with domestic constituencies and globally with partner countries.

- Budget and Performance Integration: MCC is building its assistance programs around explicit measurable results, resulting in clearly visible critical integration of program spending and performance. (Following a set of output objectives for calendar 2005, MCC has, since the end of the fiscal year, initiated a more rigorous process of developing performance goals integrated with its operating budget.)

MCC's FINANCIAL STATEMENTS

MCC financial statements, which appear on pages 36-40 of this report, received an unqualified opinion issued by the Independent Auditors. MCC management is responsible for the integrity and objectivity of the financial information presented and the audit report attests to the reliability and veracity of management information.

The financial statements provide an overview of MCC's evolving character, a lean corporation that manages a substantial development assistance fund with focused human resources. MCC's operational strategy is to maximize the use of its human capital to further its primary business objectives. Accordingly, the bulk of MCC's back office operations, such as financial, information technology and human resource management, have been outsourced, while MCC maintains overall responsibility for these functions.

MCC's key administrative costs are staff salaries and benefits, travel, rent and operational services. Salaries and benefits accounted for about 46% of all administrative costs and travel costs closely linked to due diligence and monitoring account for about 14% of all administrative costs.

MCC'S SYSTEMS, CONTROLS AND LEGAL COMPLIANCE: FEDERAL MANAGER'S FINANCIAL INTEGRITY ACT AND MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROLS (OMB A-123 (Revised))

The Federal Manager's Financial Integrity Act (FMFIA)

FMFIA requires management of federal agencies to establish controls in accordance with standards prescribed by the Comptroller General and these controls must provide reasonable assurance that:

- Obligations and costs are in compliance with applicable law;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and

- Revenues and expenditures applicable to corporate operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports.

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

On December 21, 2004 the Office of Management and Budget (OMB) revised OMB Circular A-123 *Management's Responsibility for Internal Control*, which defines management's responsibility and accountability for internal control in Federal agencies, beginning fiscal year 2006.

The revised circular reflects policy recommendations intended to strengthen the requirements for conducting management's assessment of internal control over financial reporting and emphasize the need for agencies to integrate and coordinate internal control assessments with other internal control-related activities.

In order to strengthen the internal control over financial reporting, Circular A-123 reaffirms management responsibility for establishing and maintaining internal control to achieve the following objectives:

- Effective and efficient operations;
- Reliable financial reporting; and
- Compliance with applicable laws and regulations.

Moreover, the circular requires management to consistently apply the five internal control components outlined by the GAO to meet each of the internal control objectives and to assess internal control effectiveness. In addition, the circular requires management to provide annual assurances on internal control in its Performance and Accountability Report (PAR), including a separate assurance on internal control over financial reporting, along with a report on identified material weaknesses and corrective actions.

In anticipation of the new OMB requirements applicable in FY 2006, MCC performed its first internal control assessment based on these more stringent standards by including the requirements of both the FMFIA and OMB A-123 (revised). While the material weaknesses identified in this report addresses both requirements, the CEO's certification, his annual statement in response to these findings, is limited to the scope of what is required by the FMFIA. The CEO has qualified the FMFIA assurance for FY 2005. His certification is provided below:

Federal Managers' Financial Integrity Act Certification

Based on the results of a comprehensive internal control assessment directed by management of the Millennium Challenge Corporation (MCC) and recommendations from senior officials and staff, I certify that the Corporation's management accountability and internal control systems that were in effect on

September 30, 2005 provide reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act were achieved, with the exception of the four material weaknesses identified in the Management's Discussion & Analysis portion of this report. In addition, the report includes a detailed discussion of the material weaknesses and actions that MCC will be taking in future months to resolve them.

Charles O. Sethness
November 7, 2005

The CEO's certification is based on information gathered from various sources, including MCC managers' knowledge of existing controls, day-to-day operations, a management-initiated study of risks and internal controls, and reviews and audits by the OIG and GAO. MCC's evaluation of risk also included the revised OMB A-123 guidelines that come into effect in fiscal year 2006.

In determining whether a weakness in MCC's internal controls is "material", MCC considers whether such identified weakness meets one or more of the following criteria:

- Significantly impairs the Corporation's ability to achieve its objectives;
- Results in the use of resources in a way that is inconsistent with the Corporation's mission;
- Violates statutory or regulatory requirements;
- Results in a significant lack of safeguards against waste, loss, unauthorized use, or misappropriation of funds, property, or other assets;
- Impairs the ability to obtain, maintain, report, and use reliable and timely information for decision-making;
- Permits improper or unethical conduct or a conflict of interest;
- Results in a material misstatement in the financial reports.

MCC has identified the following material internal control weaknesses and has developed an action plan to remedy these weaknesses.

Weakness # 1: **MCC's strategic plan does not fully comply with the Government Performance and Results Act (GPRA).**

Discussion: MCC did not have a strategic plan in FY 2005. MCC has made significant progress in drafting a strategic plan that is in alignment with GPRA. This act requires that federally funded organizations develop and implement an accountability system, based on performance measurement, including setting goals and objectives and measuring progress toward achieving them. While MCC has developed a set of strategic goals and means to achieve them, it has not articulated measurable performance goals which align with the 2006 – 2011 plans.

Remediation Plan: **The following actions are to be completed by March, 2006**

- Complete the development of a strategic plan for the next 6 fiscal years that meets OMB requirements.
- Involve MCC staff in the determination of corporate performance goals.
- Articulate operational performance goals which align with the defined strategic goals.

Weakness # 2: **MCC does not fully comply with the Federal Information Security Management Act (FISMA).**

Discussion: The Federal Information Security Management Act (FISMA) provides the framework for securing the federal government's information systems. Agencies covered by FISMA are required to report annually to OMB and Congress on the effectiveness of their information security programs. Specifically, FISMA requires agencies to have 1) periodic risk assessments; 2) information security policies, procedures, standards, and guidelines; 3) delegations of authority to the CIO to ensure compliance with policy; (4) security awareness training programs; (5) procedures for detecting, reporting, and responding to security incidents; and (6) plans to ensure continuity of operations. FISMA also requires an annual independent evaluation of the agency's information security program, which is separate from the Performance Assessment Report. Only significant deficiencies identified under FISMA are to be reported as a material weakness under the FMFIA. 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.

Remediation Plan: **The following actions are to be completed by September 30, 2006**

- Implement the action plan set forth in MCC's report of September 30, 2005 to implement material compliance with the requirements of FISMA by September 30, 2006.

Weakness # 3: **MCC does not fully comply with the provisions of the Federal Financial Management Information Systems Act *(FFMIA)***

Discussion: The Federal Financial Management Improvement Act (FFMIA) of 1996 is designed to improve federal financial management by requiring that financial management systems provide reliable, consistent disclosure of financial data in accordance with generally accepted accounting principles (GAAP) and standards. The FFMIA requires MCC to implement and maintain a financial management system that complies substantially with federal requirements for an integrated financial management system, applicable federal accounting standards and U.S. Standard General Ledger at the transaction level. The OIG is required to report on compliance with these requirements as part of the annual audit of MCC's financial statements.

MCC has outsourced all its back office business functions to the Department of Interior's National Business Center (NBC) under the auspices of the OMB Center of Excellence initiative. NBC uses the following systems to record MCC's transactions:

- Financial Management: Oracle Federal Financials.
- Human Resource and Payroll management: Federal Personnel and Payroll System (FPPS) and Excel spread sheets.
- Procurement: Microsoft Office Template to generate contract documents, Excel spread sheets to manage contract actions, and Oracle Federal Financials to manually record procurement transactions.
- Travel: E-Travel to perform travel authorizations and Oracle Federal Financials to manually record travel transactions.

<u>Oracle Federal Financials and Statement on Auditing Standard (SAS) 70</u>:
Because NBC is MCC's service provider, it has been essential to ensure that it performs an SAS-70 review; SAS-70 is an internationally recognized auditing standard developed by the American Institute of Certified Public Accountants (AICPA). A SAS 70 review is widely recognized, because it represents that a service organization has been through an in-depth review of its control activities, which generally include controls over information technology and related processes. Service organizations must demonstrate that they have adequate controls and safeguards when they host or process data belonging to their customers.

NBC uses the Oracle Federal Financial System to record MCC's financial transactions. While this system has been approved by the Joint Federal Management Improvement Program, the sub-systems used such as FPPS, Procurement and E-Travel are not fully integrated or interfaced. In its FY 2004 annual report, MCC identified integration as a challenge. MCC discussed these requirements at length with NBC and OMB and will continue to do so in the future.

In FY 2004, the OIG recommended that MCC request NBC to perform an SAS 70 audit of the Oracle Federal Financial System used to process MCC's financial transactions. Through this review, which was completed in September 2005 for the period March 1 through July 2005, NBC has certified its applicability with regard to the period ending September 30, 2005. As the audit did not address the entire fiscal year, the balances have been verified through alternative audit procedures. As a result, the FY 2004 OIG audit recommendation was closed.

FPPS: The FPPS system does not permit the management of staff in its entirety: organization plans; recruitment, evaluation, etc. The FPPS system is separate from the Oracle Federal Financial System (OFF) and an electronic interface has been created to record disbursements. However, this interface does not simultaneously create or link to an existing obligation of funds. In order to enable the FPPS interface, the OFF has been set up to permit the recording of a disbursement without being preceded by an obligation. This results in a less than desired level of funds control. OMB approved NBC as a "Center of Excellence for HR and Payroll services, and NBC is expected to implement a new system that will be interfaced with the OFF system that will address these shortfalls in the next two to three years.

Procurement: The procurement system used by MCC, which has not been approved by the federal government, requires manual entry of financial data into the OFF system, increasing the risk of data entry and timing errors.

E-Travel: The E-Travel system is also not integrated with the OFF system and requires manual entry of financial data, increasing the risk data entry and timing errors.

Remediation Plan: **The following actions are to be completed as indicated below**

Address the following integration issues:

- Continue to address the integration issues outside MCC's control with NBC, such as complete integration with FPPS and E-travel.
- Implement a procurement system solution by March 31, 2006.
- Ensure that all commercial off-the-shelf programs implemented by MCC and NBC are integrated and/or interfaced and that NBC performs a SAS 70 review of these functions.

Weakness # 4: **MCC has not developed or documented internal control procedures detailing the responsibilities of employees at each control level, i.e. from the data entry functions to the various administrative approvals.**

Discussion: The independent auditors have reported that MCC's operating procedures in the many functional areas such as payroll processing, budget preparation, reconciliations, accruals, travel, fixed assets, monitoring, and internal grant processes are too general or incomplete. These procedures do not identify the responsible persons at the various control levels, including the administrative approval of transactions, processing of data and data entry functions. This lack of sufficient detail and accountability in internal control procedures may result in ineffective and inefficient processing of transactions and non-compliance with laws and regulations.

Remediation Plan: **The following actions are to be completed as indicated below**

- Develop formal procedures to address the key material weaknesses identified by no later than June 30, 2006 and ensure that these policies and procedures provide internal and external timelines, and adequate internal documentation.

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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, 2005 and 2004, and the related Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources for the year ended September 30, 2005 and the nine months ended September 30, 2004. These financial statements are the responsibility of Corporation management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 of and for the year ended September 30, 2005 and as of and for the nine months ended September 30, 2004 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 four matters that we consider to be reportable conditions. We believe that one of the four reportable conditions is a material weakness.

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

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

3. MCC Policies for Disbursing Advances to Grantees Do Not Accommodate Effective Cash Management Nor the Appropriate Recording of Custodial Interest Receivable and Payable (reportable condition and noncompliance)

4. MCC's Human Resources Responsible for Managing It Financial Operations are Inadequate (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. 01-02, *Audit Requirements for Federal Financial Statements*:

1. MCC did not fully comply with FFMIA and 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 Do Not Accommodate Effective Cash Management Nor the Appropriate Recording of Custodial Interest Receivable and Payable (reportable condition 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.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying Statements of Financial Position of the Corporation as of September 30, 2005 and 2004, and the related Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources for the year ended September 30, 2005 and the nine months ended September 30, 2004. These financial statements are the responsibility of Corporation management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial positions of the Corporation as of September 30, 2005 and 2004, and changes in net position, cash flows and budgetary resources for the year ended September 30, 2005 and for the nine months ended September 30, 2004, in conformity with accounting principles generally accepted in the United States of America.

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

The accompanying Statement of Functional Expenses for the year ended September 30, 2005 and as summarized for the nine months ended September 30, 2004, 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 2005 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. 01-02 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 four matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that one reportable condition is a material weakness.

MATERIAL WEAKNESS

MCC's Policies and Procedures Were Not Always Complete and Consistent

Condition:

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.

In the prior year, we noted that draft accounting policies and procedures had been prepared but not finalized. Also, we noted that written policies and procedures were incomplete. Based on our internal control review in the current year, we noted that MCC's operating procedures in the areas of payroll processing, Fund Balance with Treasury reconciliation, quarterly accruals, annual leave accruals, travel, fixed assets, monitoring, and internal grant processes are too general or incomplete. 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.

Examples of the inconsistent or incomplete policies and procedures include:

- An advance given by MCC to Madagascar MCA was obligated and disbursed simultaneously. The proper process had not been developed and documented to ensure the MCC's Controller's involvement in the internal aspects of funds control and grants management for proper sequencing and appropriate timing of this transaction.

- MCC follows the Federal Travel Regulations for employee travel and uses E-Travel; a General Services Administration (GSA) approved and maintained electronic travel system. In our testing, however, we noted that MCC's current travel policy does not provide sufficient controls to ensure that appropriate coordination occurs with the Office of Finance and Administration to ensure that the information is captured in the financial management system, and adequate explanations from employees and approvals from supervisors are provided for expenses in excess of the per diem.

- MCC's standard funds control policy requires the recording of a commitment, followed by an obligation and then a payment. However, during our internal control testing of obligations and related disbursements, we noted the following:

  - 3 out of 80 obligation/disbursement sample items amounting to $42,661 ($513,154 projected to the obligation population) were not supported by obligating documents.

  - Per the SAS 70 review performed at the National Business Center (NBC), an Independent Audit Firm found that the Oracle Federal Financial system will allow disbursements to be made without an obligation previously being entered. This condition was primarily established to allow for the posting of payroll disbursements from another nonintegrated NBC system. Also, NBC established it to permit the recording of any disbursement or accrual without a preceding obligation. In order to mitigate this system limitation, MCC records an estimated bi-weekly payroll obligation to ensure funds availability. This manual process, however, is inefficient and increases MCC's risk.

Criteria:

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.

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:

MCC management stated that because they are a new entity, the Corporation is still developing its final procedures. Therefore, MCC management developed many informal procedures in order to meet obligation/disbursement deadlines. Recently, MCC and NBC have initiated a process in which the Controller approves miscellaneous obligation documents that are transmitted electronically to NBC.

Effect:

The lack of sufficient detail and accountability in the procedures produced inconsistent application of the travel policies and increased the risk of errors, improper recording, unauthorized transactions, omissions; potential funds control violations and noncompliance with laws and regulations. This also diminished the effectiveness and efficiency with which the financial transactions were being processed.

Recommendation # 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.

For example, prior to signing final grant agreements, the authorized signer should ensure that the fund citation is indicated and that the Controller has indicated funds availability. To record a grant obligation, a copy of the approved agreement with fund citation and indication of funds availability should be provided to the NBC accountant.

Also, the recently issued accrued annual leave policy indicates that NBC will obtain the amount of the accrued annual leave balance from FPPS. The policy, however, does not address how, who, nor acknowledge that it will mean a coordination between various NBC offices.

Management Response:

The management decision is to accept and implement this recommendation as soon as possible. We recognize that the informal procedures that served us in the past need to be formalized and procedures strengthened to align responsibilities with control objectives in order to manage and mitigate risks.

REPORTABLE CONDITIONS

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

Condition:

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 of individual travel that has taken place and the accounting for each instance. Additionally, the policy does not require that appropriate coordination include the Office of Finance and Administration. For example, the Office of Finance and Administration 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 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.

E-Travel is a GSA managed and mandated system that is used by MCC to assist the traveler in managing the travel process and processing their voucher upon their return. Although E-Travel is electronic, it does not interface with Oracle Federal Financials (OFF) and has limited functionality, such that it does not allow a traveler to submit a reclaim voucher. Currently, after the traveler prepares a voucher and the voucher is approved, the voucher is forwarded to NBC. At NBC an accounting technician manually enters each voucher into OFF.

We identified the following internal control deficiencies related to travel voucher reimbursements:

- Nine of 122 travel vouchers totaling $1,383 exceeded lodging per diem. No approvals of the lodging per diems were provided nor were the excess rejected by the system or the approving official.
- Three of 122 travel vouchers totaling $507 had "Other" costs claimed that were not documented. We noted that there was no additional explanation provided as to what the expenses were for.

Criteria:

As stated in the Government Accountability Office (GAO)'s *Standards for Internal Control in the Federal Government*, transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. This is the principal means of assuring that only valid transactions to exchange, transfer, use or commit resources, and other events are initiated or entered into. Authorizations should be clearly communicated to managers and employees. Additionally, internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. Also, the Chief Financial Officer's Act of 1990 requires each agency's CFO to develop and maintain an integrated financial management system, including financial reporting and internal control standards that comply with applicable accounting principles, standards, and requirements.

Cause:

Currently, MCC records a blanket authorization that covers all employees at the beginning of each year. The blanket authorization addresses the basic policies but does not address deviation from the standard policy. Employees are not required to submit a separate travel authorization form, for each trip, that would address any special conditions or deviations from the maximum per diems and other authorized expenses. According to MCC management, employees were requested to obtain pre-approval when they know that the rates are higher than the maximum rate allowed. However, employees did not follow procedures in these instances.

Effect:

As a result of non-enforcement of the travel policies, employee travel expenses of approximately $11,940 ($1,890 projected to the travel expense population of $3,980,087) are unsupported and potentially approved without adequate documentation. Also, there is an increased risk of travel inefficiency, and non-compliance with Federal Travel Regulations. Additionally, MCC's processing of travel vouchers is inefficient because it currently requires the manual entry of information from E-Travel to OFF. The lack of individual travel authorizations increases the difficulty and reduces the accuracy of the estimation process performed by the controller.

Recommendation #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 its Office of Finance and Administration 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.

Management Response:

The management decision is to accept and implement this recommendation as soon as possible. In this regard, MCC has recently issued its travel policy incorporating the principles enumerated in the FTR and also included procedures to strengthen the internal control environment. MCC will also reevaluate its travel authorization practices and procedures to ensure that they meet the desired control objectives. MCC has also commenced discussions with the National Business Center, Department of Interior, to determine if it would be feasible to migrate to a different General Services Administration approved software provider to accomplish travel management, as the developers of E-Travel have not met many of the requirements in a timely fashion.

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

Condition:

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.

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. 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. Furthermore, MCC's management does not agree that immediate cash needs represent a term shorter than quarterly.

Effect:

As a result of holding funds in excess of current needs, the MCA Madagascar has incurred a liability of approximately $16 thousand for the interest on the average outstanding advance. MCC has not adhered to Treasury's requirement for immediate cash needs and the US Treasury has incurred interest expenses on these funds disbursed to MCA Madagascar.

Recommendation #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.

Management Response:

MCC has not arrived at a management decision with regard to this recommendation. We believe that this recommendation needs further management study before we can come to a conclusion on this recommendation. We expect to reach a management decision within 30 days, as required by regulation.

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

Condition:

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 Finance and Administration. The current range of Controller responsibilities include, but is 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.

Criteria:

The *Standards for Internal Control in the Federal Government* states that a control activity includes management of human capital. Specifically, as part of its human capital planning, management should consider how best to retain valuable employees, plan for their eventual succession, and ensure continuity of needed skills and abilities.

Cause:

MCC's has not revamped its organizational structure to reflect the impact of its current staffing and operational levels on its Office of Finance and Administration.

Effect:

Significant reliance on a single individual to perform key financial duties can result in the following:

- Lack of a review of quarterly/annual financial statements,
- Lack of a secondary review of MCC's financial activities processed by NBC, and
- Obligations of funds prior to review of funds availability.

Additionally, it does not provide for backstops and continuity.

Recommendation # 4:

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

Management Response:

The management decision is to accept and implement this recommendation as soon as possible. As a matter of fact, MCC has advertised and is actively recruiting for an additional position – a Deputy Chief Financial Officer. The responsibilities of the positions will be clearly drawn after the staff is hired to ensure the most appropriate mix of skills.

The status of the prior year finding is provided in Appendix A.

As required by OMB Bulletin No. 01-02, 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 misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02, 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. 01-02 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. 01-02.

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 complied with the following laws and regulations:

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

MCC has not implemented and maintained a financial management system that complies substantially with Federal requirements for an integrated financial management system as required by the Federal Financial Management Improvement Act (FFMIA). 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.

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.

Criteria:

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

GPRA requires each agency to prepare an annual performance plan covering each program activity set forth in the budget of such agency. Such plan shall

(1) establish performance goals to define the level of performance to be achieved by a program activity;
(2) express such goals in an objective, quantifiable, and measurable form unless authorized to be in an alternative form under subsection (b);
(3) briefly describe the operational processes, skills and technology, and the human, capital, information, or other resources required to meet the performance goals;
(4) establish performance indicators to be used in measuring or assessing the relevant outputs, service levels, and outcomes of each program activity;
(5) provide a basis for comparing actual program results with the established performance goals; and
(6) describe the means to be used to verify and validate measured values.

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.

Cause:

The Millennium Challenge Corporation (Corporation) 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 2005 it used the only options available. NBC is working with MCC to provide enhancement to the system to accommodate MCC needs within the context of the OMB requirements for Centers of Excellence.

MCC has developed strategic goals but it has not articulated performance goals. Also, the strategic objectives were originally developed for the calendar year and not the fiscal year.

Effect:

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

Because the MCC has not established and communicated its performance goals and its strategic objectives were originally developed for the calendar year and not the fiscal year. The reader of the financial statements is not provided with a clear picture of the accountability and achievements of the Corporation.

Recommendation # 5:

We recommend that MCC management:

(1) 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.

(2) 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 6 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.

Management Response:

(1) FFMIA: The management decision is to accept this recommendation and pursue its implementation. However, MCC recognizes that the outcomes are outside its direct management control. MCC was established to be a lean efficient operation and accordingly, many facets of its back-office operations have been outsourced. MCC was required to outsource many of these functions such as financial management, human resource and payroll management, and travel management, to a USG entity, and MCC selected NBC to perform its back-office work. NBC operates on many legacy information systems that are not interfaced or integrated with MCC's core financial management system. This leads to non-compliance with FFMIA and also makes MCC operations inefficient. MCC is cognizant of these issues and identified FFMIA non-compliance as a material weakness in its FMFIA report, which is included in this report. MCC will work diligently within the span of its control to comply not only with the FFMIA requirements, but more importantly to improve its operational efficiency, effectiveness and transparency.

(2) GPRA: The management decision is to accept this recommendation and pursue its implementation. As of the date of this management response, the following actions have been undertaken:
   - ➢ A strategic plan for the next 6 fiscal years has been approved by MCC's Board and submitted to OMB.
   - ➢ A working group comprising a broad cross-section of MCC staff is actively engaged in developing corporate performance goals for FY 2006.
   - ➢ MCC management expects to adopt operational performance goals for FY 2006 and 2007 that align with the defined strategic goals, and submit these goals to MCC's Board and OMB.

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.

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

The internal control finding "MCC Policies for Disbursing Advances to Grantees Does Not Accommodate Effective Cash Management Nor the Appropriate Recording of Custodial Interest Receivable and Payable" 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 recommendation for this finding because we reported and made recommendations for corrective actions in the internal control section of this report.

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

November 7, 2005
Washington, D.C.

Appendix A

STATUS OF PRIOR YEAR FINDING

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 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.

They 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.

Management Comments and Evaluation

We received and evaluated MCC's management comments to the recommendations made in this report. We considered their comments to be responsive and have included them in their entirety in the Exhibit.

In its response MCC's management stated that it recognizes the importance of accountability, transparency and public disclosure, and that their goal is to achieve excellence in our financial management, reporting and internal control systems. Further, MCC's management commented that it will implement all but one of the recommendations as soon as possible to strengthen our systems of internal controls and lend further credibility to our financial statements. MCC's management went on to address each recommendation and provided specific dates by which it will implement these recommendations (theses dates are provided below). MCC's management also recognized and thanked both the OIG and Williams, Adley & Company, 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 recommendation nos. 1, 3, 4, and 5 provided in this report. MCC should report to the OIG when final action has been taken on the recommendations and when a management decision is reached on recommendation no. 2. The following is a brief summary of MCC's management comments on the five recommendations included in this report and our evaluation on those comments.

Recommendation No. 1

MCC management agreed with recommendation No. 1 and to implement this recommendation no later than June 30, 2006. MCC's management also commented that they recognize that the informal procedures that served them in the past need to be formalized and procedures strengthened to align responsibilities with control objectives in order to manage and mitigate risks.

Recommendation No. 2

MCC management agreed with recommendation No. 2 and will implement this recommendation no later than March 31, 2006. MCC also commented that it recently issued its travel policy incorporating the principles enumerated in the FTR and also included procedures to strengthen the internal control environment.

MCC will also reevaluate its travel authorization practices and procedures to ensure that they meet the desired control objectives. MCC has also commenced discussions with the National Business Center, Department of Interior, to determine if there are other things that can be done to improve this condition.

Recommendation No. 3

MCC management did not reach a management decision with regard to this recommendation. MCC's management commented that they believe that this recommendation needs further management study before we can come to a conclusion on this recommendation. MCC's management expects to reach a management decision within 30 days.

Recommendation No. 4

MCC management agreed with recommendation No. 4 and agreed to implement this recommendation no later than March 31, 2006. As a matter of fact, MCC has advertised and is actively recruiting for an additional position – a Deputy Chief Financial Officer. The responsibilities of the positions will be clearly drawn after the staff is hired to ensure the most appropriate mix of skills.

Recommendation No. 5

MCC management agreed with recommendation No. 5 and agreed to implement the portion of this recommendation that pertains to the GPRA no later than March 31, 2006 and the portion that pertains to FFMIA no later than September 30, 2006. MCC's management commented that as of the date of this management response 1) A strategic plan for the next 6 fiscal years has been approved by MCC's Board and submitted to OMB, 2) A working group comprising a broad cross-section of MCC staff is actively engaged in developing corporate performance goals for FY 2006, and 3) MCC management expects to adopt operational performance goals for FY 2006 and 2007 that align with the defined strategic goals, and submit these goals to MCC's Board and *OMB*, MCC's management also commented that they will work diligently within the span of its control to comply not only with the FFMIA requirements, but more importantly to improve its operational efficiency, effectiveness and transparency.

Millennium Challenge Corporation

Reducing Poverty Through Growth

November 18, 2005

To: MCC/A, John Phee

From: Vice President for Finance and Administration, Gary Keel/s/

Subject: Management response to draft Independent Auditor's Report on MCC' s Financial Statements for Fiscal Years ended September 30, 2005 and 2004, 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 principle financial statements: the Statements of Financial Position, Operations and Changes in Net Position, Cash Flows, Functional Expenses and Budgetary Resources, despite the internal control weakness that have been identified. MCC recognizes the importance of accountability, transparency and public disclosure, and our goal is to achieve excellence in our financial management, reporting and internal control systems. Accordingly, we will implement all but one of the recommendations as soon as possible to strengthen our systems of internal controls and lend further credibility to our financial statements. We wish to recognize and thank you and your team, as well as Williams, Adley & Company, for working closely with us during the audit process and especially for the excellent counsel and support you have provided us throughout the year. We look forward to working with you and your staff on the FY 2006 audit. Any questions may be addressed to Nimalka Wijesooriya, Comptroller at MCC, or to me.

Following are our management decisions regarding the proposed audit recommendations.

Material Weakness 1: MCC needs to improve its Policies and Procedures

Recommendation: We recommend that MCC's Office of Finance and Administration revise and reissue written policies and procedures that provide additional specificity in the following 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.

Management Decision: The management decision is to accept and implement this recommendation no later than June 30, 2006. We recognize that the informal procedures that served us in the past need to be formalized and procedures strengthened to align responsibilities with control objectives in order to manage and mitigate risks.

Reportable Condition 1: MCC Should Devise and Implement Improved Travel Disbursement Controls and Procedures

Recommendation: We recommend that MCC management:

(4) Develop and disseminate explicit policies to ensure that employees are aware of and follow the Federal Travel Regulations. Any exception should be documented as to why and approved by a manager/supervisor in writing.
(5) Institute policies and procedures to ensure proper authorizations and approvals are obtained and coordination with the Office of Finance and Administration has occurred for each planned travel prior to the travel occurrence including ensuring funds availability.
(6) 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.

Management Decision: The management decision is to accept and implement this recommendation no later than March 31, 2006. In this regard, MCC has recently issued its travel policy incorporating the principles enumerated in the FTR and also included procedures to strengthen the internal control environment. MCC will also reevaluate its travel authorization practices and procedures to ensure that they meet the desired control objectives. MCC has also commenced discussions with the National Business Center, Department of Interior, to determine if it would be feasible to migrate to a different General Services Administration approved software provider to accomplish travel management, as the developers of E-Travel have not met many of the requirements in a timely fashion.

Reportable Condition 2: MCC Needs to Address its Policies on Immediate Cash Needs and the Accruing of Interest on Grant Funds

Recommendation: We recommend that management:

(3) 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.
(4) 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.

Management Decision: MCC has not arrived at a management decision with regard to this recommendation. We believe that this recommendation needs further management study before we can come to a conclusion on this recommendation. We expect to reach a management decision within 30 days, as required by regulation.

Reportable Condition 3: MCC Needs to Address Human Capital Needs in Office of Finance and Administration

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

Management Decision: The management decision is to accept and implement this recommendation no later than March 31, 2006. As a matter of fact, MCC has advertised and is actively recruiting for an additional position – a Deputy Chief Financial Officer. The responsibilities of the positions will be clearly drawn after the staff is hired to ensure the most appropriate mix of skills.

Material Noncompliance: MCC Did Not Fully Comply with FFMIA and GPRA

Recommendation: We recommend that MCC management:

(3) Implement their intended corrective actions for preparation of a GPRA based performance goals and objectives by March 2006 as specified in its FFMIA assessment, specifically:
   - Complete the development of a strategic plan for the next 6 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; and

(4) Assess the automated options available to handle MCC operations and develop short range and long range plans for the implementation 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:

(1) **GPRA:** The management decision is to accept this recommendation and complete implementation by no later than March 31, 2006. As of the date of this management response, the following actions have been undertaken:

- A strategic plan for the next 6 fiscal years has been approved by MCC's Board and submitted to OMB.
- A working group comprising a broad cross-section of MCC staff is actively engaged in developing corporate performance goals for FY 2006.
- MCC management expects to adopt operational performance goals for FY 2006 and 2007 that align with the defined strategic goals, and submit these goals to MCC's Board and OMB.

(2) **FFMIA:** The management decision is to accept this recommendation and complete implementation by no later than September 30, 2006. However, MCC recognizes that the outcomes are outside its direct management control. MCC was established to be a lean efficient operation and accordingly, many facets of its back-office operations have been outsourced. MCC was required to outsource many of these functions such as financial management, human resource and payroll management, and travel management, to a USG entity, and MCC selected NBC to perform its back-office work. NBC operates on many legacy information systems that are not interfaced or integrated with MCC's core financial management system. This leads to non-compliance with FFMIA and also makes MCC operations inefficient. MCC is cognizant of these issues and identified FFMIA non-compliance as a material weakness in its FMFIA report, which is included in this report. MCC will work diligently within the span of its control to comply not only with the FFMIA requirements, but more importantly to improve its operational efficiency, effectiveness and transparency.

Millennium Challenge Corporation
Statement of Financial Position
As of September 30, 2005 and 2004

	2005 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2004 Total
Assets								
Current Assets								
Fund Balance with Treasury *(Note 2)*	$ 2,358,547,000	$ 2,273,365,909	$ 21,843,188	$ 20,000,000	$ 19,546,020	$ 23,110,024	$ 681,859	$ 989,816,579
Receivables/Advances/Prepayments *(Note 3)*	4,338,698	1,805,924	-	-	2,500,000	32,774	-	168,599
Fixed Assets								
Leasehold Improvements *(Note 4)*	4,244,059	-	-	-	-	4,244,059	-	-
Total Assets	$ 2,367,129,757	$ 2,275,171,833	$ 21,843,188	$ 20,000,000	$ 22,046,020	$ 27,386,857	$ 681,859	$ 989,985,178
Liabilities								
Accounts Payable	1,319,468	-	-	-	72,130	1,247,338	-	32,884
Other Liabilities *(Note 5)*	2,522,803	-	154,527	-	997,921	919,546	450,809	854,625
Accrued Funded Annual Leave	1,386,644	-	-	-	-	1,386,644	-	169,901
Total Liabilities	$ 5,228,915	$ -	$ 154,527	$ -	$ 1,070,051	$ 3,553,528	$ 450,809	1,057,410
Net Position								
Unexpended Appropriations								
Obligated/Undelivered Orders	$ 349,153,392	$ 324,078,000	$ 6,144,307	$ -	$ 8,800,260	$ 9,899,775	$ 231,050	$ 2,765,191
Unobligated - Encumbered	606,634,745	580,378,488	15,398,801	-	5,423,455	5,434,001	-	-
Unobligated - Unencumbered	1,401,835,873	1,370,715,345	145,553	20,000,000	6,752,254	4,222,721	-	986,171,577
Cumulative Results of Operations	4,276,832	-	-	-	-	4,276,832	-	-
Total Net Position *(Note 6)*	$ 2,361,900,842	$ 2,275,171,833	$ 21,688,661	$ 20,000,000	$ 20,975,969	$ 23,833,329	$ 231,050	$ 988,936,768
Total Liabilities and Net Position	$ 2,367,129,757	$ 2,275,171,833	$ 21,843,188	$ 20,000,000	$ 22,046,020	$ 27,386,857	$ 681,859	$ 989,994,178

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statement of Operations and Changes in Net Position
For the year ended September 30, 2005 with summary totals for the nine months ended September 30, 2004

	2005 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2004 Total
Revenues								
Appropriations Used	$ 39,312,758	$ 695,000	$ 311,339	$ -	$ 3,024,031	$ 33,208,694	$ 2,073,694	$ 5,163,232
Expenses	35,035,926	695,000	311,339	-	3,024,031	28,931,862	2,073,694	5,163,232
Excess of Revenues over Expenses	$ 4,276,832	$ -	$ -	$ -	$ -	$ 4,276,832	$ -	$ -
Net Position								
Excess of Revenues over Expenses	4,276,832	-	-	-	-	4,276,832	-	-
Increase in Unexpended Appropriations								
Appropriated								
Obligated/Undelivered Orders	346,388,202	324,078,000	6,144,307		8,800,260	7,134,585	231,050	2,765,191
Unobligated - Encumbered	626,634,744	580,378,488	15,398,801	20,000,000	5,423,455	5,434,000	-	-
Unobligated - Unencumbered	407,664,296	396,543,768	145,553		6,752,254	4,222,721	-	992,071,577
Permanent Recission	(12,000,000)	(12,000,000)	-	-	-	-	-	(5,900,000)
Total Increase in Unexpended Appropriations	$ 1,372,964,074	$ 1,289,000,256	$ 21,688,661	$ 20,000,000	$ 20,975,969	$ 21,068,138	$ 231,050	$ 988,936,768
Beginning Net Position	$ 988,936,768	$ 986,171,577	$ -	$ -	$ -	$ 2,765,191	$ -	$ -
Ending Net Position	$ 2,361,900,842	$ 2,275,171,833	$ 21,688,661	$ 20,000,000	$ 20,975,969	$ 23,833,329	$ 231,050	$ 988,936,768

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statement of Functional Expenses
For the year ended September 30, 2005 with summary totals for the nine months ended September 30, 2004

	2005 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2004 Total
Salary and Benefits	$13,343,440	$ -	$ -	$ -	$ 1,603	13,341,837	$ -	$ 2,185,333
Travel	3,980,087	-	-	-	-	3,980,087	-	460,463
Rent/Lease	718,546	-	-	-	-	718,546	-	322,833
Utilities	207,704	-	-	-	-	207,704	-	170,241
Information Technology Services	2,065,657	-	-	-	-	2,065,657	-	502,286
Accounting Services	3,186,484	-	-	-	-	1,112,790	2,073,694	316,496
Interagency Agreements	564,654	-	-	-	564,654	-	-	-
Other Services	6,082,697	-	-	-	2,363,004	3,719,693	-	893,483
Supplies and Equipment	2,671,882	-	-	-	-	2,671,882	-	102,368
Grants	1,024,133	695,000	311,339	-	-	17,794	-	-
Miscellaneous	1,190,642	-	-	-	94,770	1,095,872	-	209,729
Total Expenses	$ 35,035,926	$ 695,000	$ 311,339	$ -	$ 3,024,031	$ 28,931,862	$ 2,073,694	$ 5,163,232

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statement of Cash Flows
For the year ended September 30, 2005 with summary totals for the nine months ended September 30, 2004

	2005 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2004 Total
Cash Flows from Operating Activities								
Excess of Revenues over Expenses	$ 4,276,832	$ -	$ -	$ -	$ -	$ 4,276,832	$ -	$ -
Adjustments Affecting Cash Flow:								
Appropriated Capital Used	(39,312,758)	(695,000)	(311,339)	-	(3,024,031)	(33,208,694)	(2,073,694)	(5,163,232)
Decrease (Increase) in Advances/Receivables/Prepayments	(4,170,099)	(1,805,924)	-	-	(2,500,000)	135,825	-	(168,599)
Increase in Accounts Payable	1,295,584	-	-	-	72,130	1,223,454	-	23,884
Decrease in Other Liabilities	1,668,178	-	154,527	-	997,921	421,105	94,625	854,625
Increase in Annual Funded Leave Liabilities	1,216,743	-	-	-	-	1,216,743	-	169,901
Total Adjustments	$ (39,302,352)	$ (2,500,924)	$ (156,812)	$ -	$ (4,453,980)	$ (30,211,567)	$ (1,979,069)	$ (4,283,421)
Net Cash Used in Operating Activities	$ (35,025,520)	$ (2,500,924)	$ (156,812)	$ -	$ (4,453,980)	$ (25,934,735)	$ (1,979,069)	$ (4,283,421)
Cash Flows from Investing Activities								
Purchase of Property	$ (4,244,059)	$ -	$ -	$ -	$ -	$ (4,244,059)	$ -	$ -
Net Cash Used in Investing Activities	$ (4,244,059)	$ -	$ -	$ -	$ -	$ (4,244,059)	$ -	$ -
Cash Flows from Financing Activities								
Appropriations received net of recissions	$ 1,488,000,000	$1,289,695,256	$ 22,000,000	$ 100,000,000	$ 24,000,000	$ 50,000,000	$ 2,304,744	$ 994,100,000
Transfers Out	(80,000,000)			(80,000,000)				
Net Cash Provided by Financing Activities	$ 1,408,000,000	$1,289,695,256	$ 22,000,000	$ 20,000,000	$ 24,000,000	$ 50,000,000	$ 2,304,744	$ 994,100,000
Net Increase in Cash	$ 1,368,730,421	$1,287,194,332	$ 21,843,188	$ 20,000,000	$ 19,546,020	$ 19,821,206	$ 325,675	$ 989,816,579
Fund Balance with Treasury, Beginning	$ 989,816,579	$ 986,171,577	$ -	$ -	$ -	$ 3,288,818	$ 356,184	$ -
Fund Balance with Treasury, Ending	$ 2,358,547,000	$2,273,365,909	$ 21,843,188	$ 20,000,000	$ 19,546,020	$ 23,110,024	$ 681,859	$ 989,816,579

The footnotes are an integral part of these financial statements

Millennium Challenge Corporation
Statement of Budgetary Resources
For the year ended September 30, 2005 with summary totals for the nine months ended September 30, 2004

	2005 Total	Compacts	Pre-Compact Funding	Threshold	Evaluation and Support	Administrative	Audit	2004 Total
Budgetary Resources:								
Budget Authority:								
Appropriations	$ 1,500,000,000	$ 1,301,695,256	$ 22,000,000	$100,000,000	$ 24,000,000	$ 50,000,000	$ 2,304,744	$ 1,000,000,000
Net Transfer, Current Year Authority								
Unobligated Balance - Beginning of Period	986,171,577	986,171,577						
Unobligated Balance - Transferred								
Spending Authority from Offsetting Collections	-							
Advances Received	-							
Adjustments:								
Recoveries of Prior Years Obligations	-							
Permanently Not Available *(Note 7)*	(12,000,000)	(12,000,000)	-	-	-	-	-	(5,900,000)
Total Budgetary Resources	$ 2,474,171,577	$ 2,275,866,833	$ 22,000,000	$100,000,000	$ 24,000,000	$ 50,000,000	$ 2,304,744	$ 994,100,000
Status of Budgetary Resources:								
Obligations Incurred	$ 420,449,393	$ 324,773,000	$ 6,455,646	$ 34,748,434	$ 11,824,290	$ 40,343,279	$ 2,304,744	$ 7,928,423
Unobligated Balance Available:								
Apportioned	683,006,839	580,378,488	15,544,354	65,251,566	12,175,710	9,656,721	-	-
Unobligated Balance Not Available:	1,370,715,345	1,370,715,345	-	-	-	-	-	-
Total Status of Budgetary Resources	$ 2,474,171,577	$ 2,275,866,833	$ 22,000,000	$100,000,000	$ 24,000,000	$ 50,000,000	$ 2,304,744	$ 7,928,423
Relationship of Obligations to Outlays:								
Obligated Balance, Net - as of October 1, 2004	$ 3,645,002	$ -	$ -	$ -	$ -	$ 3,645,002	$ -	$ -
Obligations Incurred	420,244,138	324,773,000	6,298,834	34,699,991	11,824,290	40,343,279	2,304,744	7,928,423
Recoveries of Prior Years Obligations	-							
Adjustments								
Obligated Balance, Net - End of Period								
Accounts Payable	(5,335,899)	-	(154,527)	(21,353)	(1,070,051)	(3,639,159)	(450,809)	(1,048,410)
Undelivered Orders	(379,526,106)	(322,272,076)	(6,144,307)	(34,678,638)	(6,300,260)	(9,899,775)	(231,050)	(2,596,592)
Total Outlays	$ 39,027,135	$ 2,500,924	$ -	$ -	$ 4,453,979	$ 30,449,347	$ 1,622,885	$ 4,283,421
Outlays:								
Disbursements	39,232,391	2,500,924	156,813	48,443	4,453,980	30,449,346	1,622,885	4,283,421
Collections / Refunds	-							
Net Outlays	$ 39,232,391	$ 2,500,924	$ 156,813	$ 48,443	$ 4,453,980	$ 30,449,346	$ 1,622,885	$ 4,283,421

The footnotes are an integral part of these financial statements

Note 1 – Summary of Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position, results of operations, cash flows, and budgetary resources for the Millennium Challenge Corporation (the Corporation), as required by Section 613 of the Millennium Challenge Act of 2003 and the Government Corporation Control Act (31 USC 9106). The Corporation was formed on January 23, 2004. These financial statements have been prepared from the books and records of the Corporation and are presented in accordance with the applicable form and content requirements of the Office of Management and Budget, the Secretary of the Treasury, and the Government Management and Reform Act of 1994.

The corporations accounting policies follow generally accepted accounting principles for the federal government, as recommended by the Federal Accounting Standards Advisory Board (FASAB). The Corporation is not subject to income tax.

The principal financial statements of the Corporation are the:

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

These statements are comparative between fiscal years 2004 and 2005. Since the Corporation was only formed in January 2004, fiscal year 2004 only represents nine months of data, while fiscal year 2005 represents twelve months of data. The notes to the financial statements are considered an integral part of the financial statements.

B. Reporting Entity

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

The Millennium Challenge Act provides specific authorities to MCC that result in the following definitions that are used in these statements:

Compact: An agreement entered in to between the Corporation and an eligible country that establishes and funds a multi-year plan for achieving development objectives.

Pre-Compact Funding: Contracts or Grants made by the Corporation to an eligible country for the purpose of facilitating the development and implementation of a compact.

Threshold: Assistance provided by the Corporation to a candidate country for the purpose of assisting that country to become eligible for Compact funding from the Corporation.

Evaluation and Support: Program budgetary resources to assess and work with countries on key elements of program development and implementation, including program results and impact measurement and management.

Administrative: Budgetary resources to meet the administrative and overhead expenses.

Audit: Budgetary resources provided to the Inspector General of the Corporation to conduct reviews, investigations and inspections of all aspects of the operations and activities of the Corporation.

C. Budgets and Budgetary Accounting

The activities of the Corporation are funded through No-Year Appropriations, wherein the funds are available for obligation without fiscal year limitation and remain available until expended. MCC was provided a total appropriation of $1.5 billion for Fiscal Year 2005. MCC's Administrative, Evaluation and Support, and Audit funds are limited as to amount and it is MCC's policy to transfer all unobligated funds at the end of the year in these categories to the Compacts fund at the beginning of the next fiscal year.

The Threshold Program is implemented by the United States Agency for International Development (USAID) under an "Appropriation Allocation" wherein the obligation authority for the funds provided the Corporation is transferred to USAID; the funds remain in MCC's account but MCC allocates them to USAID for obligation. USAID is responsible for obligating these funds and meeting the financial reporting requirements stipulated by MCC. Accordingly, USAID will be presenting the net cost and proprietary balances on its financial statements.

D. Basis of Accounting

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

Budgetary accounting facilitates 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 an 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. The U.S. Treasury processes all cash receipts and disbursements for the corporation. The Fund Balance with Treasury represents no-year funds, which are maintained in appropriated funds that are available to pay current and future commitments.

F. Advances to Others

The Corporation advances funds, primarily in response to grantee and Federal agency drawdown requests, to facilitate completion of any approved grant or inter-agency agreement.

G. Property and Equipment

The Corporation capitalizes property and equipment at historical cost for acquisitions of $25 thousand or more, with an estimated useful life of two or more years. These assets can include leasehold improvements, telephone equipment, computer systems equipment, copiers, computer software, furniture, and assets under capital leases. These assets are depreciated (or amortized) over estimated useful lives ranging from two to 10 year, using the half-year convention. The Corporation records a full year's depreciation when assets are placed in to service during the first half of the fiscal year and no depreciation when assets are placed in the second half of the fiscal year. Accordingly, no depreciation was taken in fiscal year 2005. Normal maintenance and repair costs on capitalized property and equipment are expensed when incurred.

H. Grants (Compacts and Pre-Compact Funding) Payable

Grants are made to eligible countries with an approved Compact or Pre-Compact funding agreement. Grants become budgetary obligations, but not liabilities, when they are awarded and enter in to legal force. At the end of each fiscal year, the Corporation reports the total amount of unreimbursed authorized grantee expenses, incurred under the terms of the grants, as a payable. The balance at the end of FY 2005 was $0.

I. Accounts Payable

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

J. Actuarial FECA Liability

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

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

The Corporation has no FECA liabilities incurred during fiscal year 2005. Therefore, none are reflected on the statements for this fiscal year.

K. Other Liabilities

Other liabilities included amounts owed but not paid at the end of the fiscal year for payroll and benefits; and the portion of the liability for the Federal Employees' Compensation Act charges incurred and billed but unpaid.

L. Accrued Annual Leave

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

M. Net Position

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

N. Revenues

Appropriations used: The Corporation obtains funding for its program and operating expenses through no-year appropriations. Appropriations are recognized as an accrual-based financing source at the time they are used to pay program or administrative expenses, except for expenses to be funded by future appropriations.

O. Retirement Benefits

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

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

The Corporation made retirement contributions of $30 thousand to the CSRS Plan and $876 thousand and $226 thousand to the FERS and TSP Plans in fiscal year 2005.

P. Use of Estimates

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

Q. Contingencies

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

R. Judgment Fund

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

S. Donated Services

The Corporation utilizes donated services from other Federal agencies and private firms in the course of business operations. The approximate fair market value of these donated services during the fiscal year is $515,000. This amount is not material and therefore, is not reflected in the financial statements.

T. Custodial Receivable and Liability

It is expected that the Corporation will fund all its Compacts with advances that are required to be placed in an interest-bearing account, if legally feasible, until disbursed. The interest earned on these accounts are refunded to the Corporation and deposited in to an account at the U.S. Treasury. The receivable and related liabilities are not reflected in these financial statements. As at September 30, 2005, the Corporation had outstanding advances related to compact financing of approximately $1.8 million and the interest earned is estimated at about $ 17,000.

Note 2 – Fund Balance with Treasury

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

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

	2005	2004
Appropriated Funds		
Unobligated	1,973,684,995	986,171,577
Obligated	384,862,005	3,645,002
Total	$ 2,358,547,000	$ 989,816,579

Note 3 – Advances/Accounts Receivable

Advances reflect amounts provided grantee countries and other Federal agencies, in accordance with their 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.

Note 4 – Leasehold Improvements

The only capitalized asset is the leasehold improvements on MCC headquarter offices located at 875 15th Street, NW, Washington, DC, 2005. Occupancy of this building by the Corporation began in July 2005. MCC's policy is to use the straight line method for computing depreciation.

Note 5 – Other Liabilities

Other Liabilities as of September 30
(In Dollars)

Type	2005	2004
Evaluation and Support	$ 997,921	$ 0
Travel	$ 747,143	$ 81,001
Office of the Inspector General	$ 450,809	$ 356,184
Miscellaneous	$ 326,930	$ 87,224
Payroll	$ 0	$ 330,216
Total	$ 2,522,803	$ 854,625

Note 6 – Net Position

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

Breakdown of Obligated/Undelivered Orders and Unobligated–Encumbered grant funds:

	2005	Compacts	Pre-Compact Funding	2004
Obligated/Undelivered Orders:				
Madagascar	$ 110,378,000	$ 109,078,000	$ 1,300,000	$ -
Honduras	$ 215,000,000	$ 215,000,000		
Georgia	$ 4,111,000		$ 4,111,000	
Ghana	$ 48,688		$ 48,688	
Lesotho	$ 600,000		$ 600,000	
Cape Verde	$ 84,619		$ 84,619	
Total - Obligated/Undelivered Order	**$ 330,222,307**	**$ 324,078,000**	**$ 6,144,307**	**$ -**
Unobligated-Encumbered				
Cape Verde	$ 110,078,488	$ 110,078,488	$ -	$ -
Nicaragua	$ 175,000,000	$ 175,000,000		
Georgia	$ 295,300,000	$ 295,300,000		
Ghana	$ 2,870,502		$ 2,870,502	
Senegal	$ 6,528,299		$ 6,528,299	
Mazambique	$ 6,000,000		$ 6,000,000	
Total - Unobligated-Encumbered	**$ 595,777,289**	**$ 580,378,488**	**$15,398,801**	**$ -**

Note 7 – Permanent Rescission

In fiscal years 2005 and 2004, respectively, $12 million and $ 5.9 million of amounts previously appropriated under the FY 2005 and FY 2004 Foreign Operations, Export Financing, and Related Programs Appropriations Acts (Public Law 108-447 and Public Law 108-199, respectively), were rescinded. The rescissions were part of the Across-the-Board Rescissions enacted for fiscal years 2005 and 2004.