MILLENNIUM CHALLENGE CORPORATION
UNITED STATES OF AMERICA

2012 annual report

MCC: A NEW STANDARD FOR AID EFFECTIVENESS

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Millennium Challenge Corporation
United States of America
October 1, 2011 to September 30, 2012

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Message from **Secretary of State Hillary Rodham Clinton**

Chair of the MCC Board of Directors

Development effectiveness is more than a principle we believe in. It also drives our practices as we partner worldwide to create opportunities for sustainable economic growth and for improving the human condition. In these resource-constrained times, we owe it to ourselves and our partners to ensure that our development investments deliver maximum effectiveness. I have believed in this goal throughout my professional career, and I am proud of the work underway through the U.S. Government's Millennium Challenge Corporation, whose Board I chair, to practice a new standard for aid effectiveness that demands accountability.

Development is an essential pillar of our national security, alongside defense and diplomacy, and MCC offers a non-traditional approach to making it as effective as possible. MCC helps partners transition from aid to investment. By creating powerful incentives for sound democratic and economic governance, MCC effectively encourages partner countries to deepen their political will and reform their policies at the national, sector, and institutional levels so they can mobilize their own domestic resources for long-term economic growth and self-sustaining progress. MCC also advances the concept of country-owned development, tapping partners to lead and implement their development strategies to reflect broad-based and inclusive input from government, civil society, the private sector, and citizens—both men and women. And, MCC is committed to monitoring, evaluating, and measuring the performance of both partners and projects, as an essential component for achieving better results and lasting impact.

From the compacts it has completed to its groundbreaking work on independent evaluations that rigorously measure impact, MCC is increasingly seen as the proving ground for what is possible in development. Because of its commitment to continuous improvement and learning, MCC pushes itself and offers incredibly valuable lessons to the rest of the U.S. Government and other donors on practicing effective development. Through selectivity based on policy performance, country ownership, and a focus on delivering results and impact, MCC challenges us all to make sure development works to solve problems, change lives, and create a future of greater freedom, democracy, opportunity, and dignity.

I am confident that MCC will continue to deliver development effectiveness in ways that empower countries toward self-sufficiency and toward that day when they will no longer need assistance. With ongoing support from Congress, development experts, and the American people, we can—and will—help our partners build strong public institutions and civil societies, generate robust private sector investments and mutually-beneficial trading relationships, and afford their citizens a chance, through their own hard work, to forge better lives for themselves and their families. Ultimately, effective development, grounded in these principles and practices, serves our shared interests and advances our common prosperity.

Hillary Rodham Clinton, Chair

"In this Administration under President Obama, we've tried to put forth a new policy on development that really focuses on results, and MCC has been one of the foundational institutions that has given us the base for moving forward... MCC's model showcases some of our best thinking about how to do development for the 21st century, and has helped to set the stage for the Administration's approach for development, because at a time when we must look for the way to maximize the impact of every dollar that we spend on development, we often turn to MCC for information and inspiration."

—Secretary of State Hillary Rodham Clinton during her visit to MCC, November 27, 2012

Message from Daniel W. Yohannes

Chief Executive Officer

The U.S. development community is united in the common purpose of delivering foreign assistance as effectively as possible. We owe effective solutions not just to the world's poor who seek a better life of greater opportunity, but also to the American taxpayers who rightfully demand a return from their investment of tax dollars. In these challenging economic times, the pursuit of efficiency in development depends on the pursuit of effectiveness.

For our part at the Millennium Challenge Corporation, we are setting a new standard for aid effectiveness, pushing ourselves, our partner countries and others in development to embrace the principles and practices that deliver results and sustainable impact. Our work is grounded in selectivity, country-owned development, accountability, transparency, and a focus on results. These are central to our model and to our values. As we practice these principles, we are learning more about what works and what does not work. We are committed to incorporating this learning into a process of continuous improvement to find and implement the optimal solutions for delivering sustainable development that changes the lives of the world's poor in positive ways and creates conditions for economic growth that benefit all of us. We have been—and will remain—scrupulous and rigorous in evaluating our programs and impact in order to improve our processes and outcomes moving forward.

I believe we are on the right track. I have met with farmers and entrepreneurs in Ghana and Benin who are capitalizing on efficient ways to get their produce to market or register their small businesses, boosting their incomes and their quality of life. I can never forget the students in El Salvador who are gaining the skills to compete through MCC-funded technical training or the students in Namibia who now have a textbook of their own to read. I am impressed with the range of policy reforms our partner countries have made to sustain their investments, from the reforms Lesotho made in land administration to the ones Armenia made in water resource management. These are just a few examples that showcase the continuum of results MCC partnerships around the world are making possible.

The principles we practice at MCC are fueling a wholesale rethinking about what works in development among others in the field. I am thrilled that the innovations of MCC's model—and the results we see underway—are inspiring and influencing the development community to adopt many of MCC's key principles and practices. Through ongoing learning and sharing lessons and best practices, we are helping to make the discipline of development even stronger and more impactful.

The world's poor deserve this. The American taxpayer and all our stakeholders in Congress, the private sector and nongovernmental organizations demand this. Ultimately, we expect this accountability of ourselves as we lead the way in setting a new standard for development effectiveness through the principles we will continue to refine and practice.

Daniel W. Yohannes, Chief Executive Officer

MCC's **Board of Directors**

(As of September 30, 2012)

The Secretary of State (Chair), the Secretary of the Treasury (Vice Chair), the U.S. Trade Representative, the U.S. Agency for International Development Administrator, MCC's CEO, and four individuals from the private sector appointed by the President with the advice and consent of the U.S. Senate make up MCC's public-private Board of Directors. The Board's private sector component is one of MCC's most distinctive features.

1 *Hillary Rodham Clinton, Chair*
Secretary of State

2 *Timothy F. Geithner, Vice Chair*
Secretary of the Treasury

3 *Ambassador Ron Kirk*
U.S. Trade Representative

4 *Dr. Rajiv Shah*
Administrator, U.S. Agency for International Development

5 *Daniel W. Yohannes*
MCC Chief Executive Officer

6 *Mark Green*
Senior Director, U.S. Global Leadership Coalition

7 *Alan J. Patricof*
Founder and Managing Director, Greycroft, LLC

MCC's **Senior Management**

(As of September 30, 2012)

Cassandra Q. Butts, Senior Advisor
Office of the Chief Executive Officer

T. Charles Cooper, Vice President
Department of Congressional and Public Affairs

Patrick C. Fine, Vice President
Department of Compact Operations

Sheila Herrling, Vice President
Department of Policy and Evaluation

Steven M. Kaufmann, Chief of Staff
Office of the Chief Executive Officer

Frances Reid, Senior Investment and Risk Officer
Office of the Chief Executive Officer

Melvin F. Williams, Jr., Vice President
General Counsel and Corporate Secretary

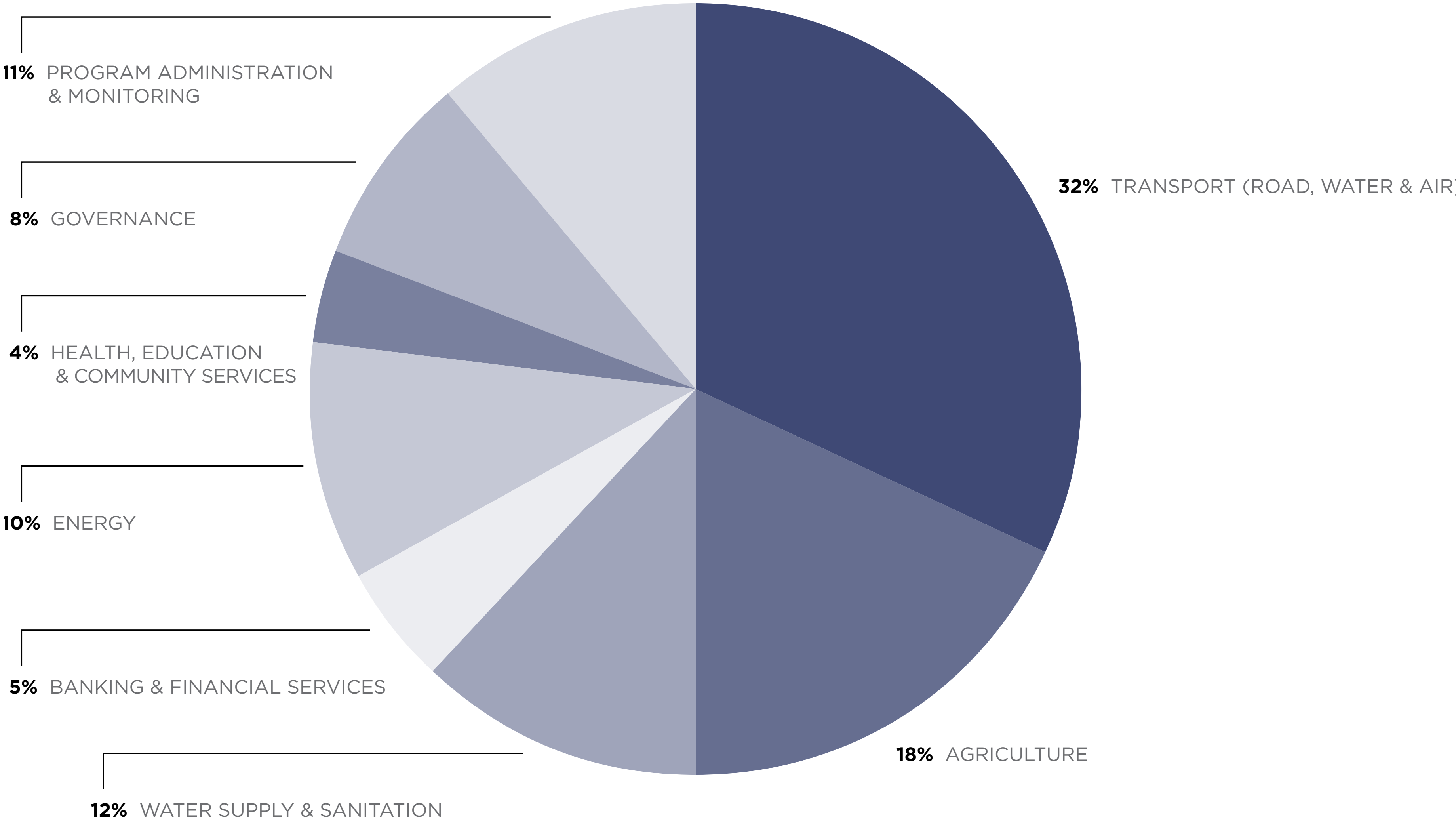
Chantale Yokmin Wong, Vice President and Chief Financial Officer
Department of Administration and Finance

DELIVERING RESULTS THAT MATTER IN THE LIVES OF THE WORLD'S POOR

MCC IS COMMITTED TO THE WORLD'S POOR. SEE WHAT OUR INVESTMENTS WORLDWIDE HAVE ACHIEVED, BY THE NUMBERS AND BY THE TANGIBLE CHANGES IN THE LIVES OF BENEFICIARIES.

Total Compact **Investments by Sector**

(As of September 2012)



Definition: **Compact**
Refers to time-limited, five-year grants approved by MCC's Board of Directors and awarded to countries that meet MCC's eligibility criteria.

Amount in $ millions	
SECTOR	**Amount**
TRANSPORT (ROAD, WATER & AIR)	$2,922.9
AGRICULTURE	$1,604.3
WATER SUPPLY & SANITATION	$1,110.8
BANKING & FINANCIAL SERVICES	$451.1
ENERGY	$945.6
HEALTH, EDUCATION & COMMUNITY SERVICES	$374.0
GOVERNANCE	$734.9
PROGRAM ADMINISTRATION & MONITORING	$996.8
Total	**$9,140.4**

Dates to Note during Fiscal Year 2012

- **October 2011: Completion of Benin's compact**
- **November 2011: Signing of Indonesia's compact**
- **February 2012: Signing of Cape Verde's second compact**
- **February 2012: Completion of Ghana's compact**
- **May 2012: Signing of Zambia's compact**
- **June 2012: Reinstatement of Malawi's compact**
- **August 2012: Termination of Mali's compact**
- **September 2012: Completion of El Salvador's compact**

Compact Portfolio **Financial Status**

(In Millions of Dollars)

Country	EIF Date	Months Remaining	Time Elapsed	Compact Amount	Cumulative Commitments	% of Compact Committed	Cumulative Disbursements	% of Commitments Disbursed
	Compact Information				Cumulative Progress			
MADAGASCAR	Jul-05	0	100%	85.6	85.6	100%	85.6	100%
HONDURAS	Sep-05	0	100%	205.0	204.0	100%	204.0	100%
CAPE VERDE I	Oct-05	0	100%	110.1	108.5	99%	108.5	100%
GEORGIA	Apr-06	0	100%	395.3	387.2	98%	387.2	100%
VANUATU	Apr-06	0	100%	65.4	65.4	100%	65.4	100%
NICARAGUA	May-06	0	100%	112.7	112.7	100%	112.7	100%
ARMENIA	Sep-06	0	100%	177.7	176.6	99%	176.6	100%
BENIN	Oct-06	0	100%	301.8	301.8	100%	301.8	100%
GHANA	Feb-07	0	100%	547.0	540.0	99%	540.0	100%
EL SALVADOR	Sep-07	0	100%	460.9	432.3	94%	432.3	100%
MALI	Sep-07	0	100%	460.8	434.0	94%	428.7	99%
MOROCCO	Sep-08	11	82%	697.5	598.9	86%	360.0	60%
LESOTHO	Sep-08	11	82%	362.6	311.3	86%	195.7	63%
MOZAMBIQUE	Sep-08	11	82%	506.9	427.2	84%	202.0	47%
TANZANIA	Sep-08	11	82%	698.1	645.8	93%	344.9	53%
MONGOLIA	Sep-08	11	82%	284.9	247.5	87%	163.2	66%
BURKINA FASO	Jul-09	21	65%	480.9	146.2	30%	138.9	95%
NAMIBIA	Sep-09	23	62%	304.5	212.5	70%	104.9	49%
SENEGAL	Sep-10	35	42%	540.0	48.4	9%	12.8	26%
MOLDOVA	Sep-10	35	42%	262.0	127.8	49%	24.7	19%
PHILIPPINES	May-11	43	28%	433.9	160.9	37%	45.0	28%
JORDAN	Dec-11	50	17%	275.1	148.3	54%	15.4	10%
INDONESIA	TBD	60	0%	600.0	0.0	0%	0.0	0%
MALAWI	TBD	60	0%	350.7	0.0	0%	0.0	0%
CAPE VERDE II	TBD	60	0%	66.2	0.4	1%	0.3	80%
ZAMBIA	TBD	60	0%	354.8	9.4	3%	1.3	14%
GRAND TOTAL				**9140.4**	**5932.6**	**65%**	**4452.1**	**75%**

% of Compact Disbursed	Commitments Oct'11 to Sep'12	Targets Oct'11 to Sep'12	Performance against Targets	Disbursements Oct'11 to Sep'12	Targets Oct'11 to Sep'12	Performance against Targets
	Year-to-date Performance					
100%	0.0	0.0		0.0	0.0	
100%	0.0	0.0		0.0	0.0	
99%	0.0	0.0		0.0	0.0	
98%	0.0	0.0		0.0	0.0	
100%	0.0	0.0		-0.1	0.0	
100%	0.0	0.0		0.0	0.0	
99%	0.0	0.0		21.0	0.0	
100%	4.4	0.0		39.2	0.0	
99%	22.8	6.7	340%	148.7	154.3	96%
94%	17.6	42.2	42%	137.1	161.0	85%
93%	9.8	37.5	26%	140.1	148.9	94%
52%	122.5	147.3	83%	163.7	258.2	63%
54%	65.7	84.7	78%	84.2	123.6	68%
40%	46.5	51.8	90%	105.2	199.5	53%
49%	30.0	30.0	100%	129.6	221.1	59%
57%	120.5	116.5	103%	96.4	116.6	83%
29%	13.6	197.3	7%	64.2	118.0	54%
34%	44.0	104.4	42%	52.4	74.2	71%
2%	38.5	203.6	19%	7.3	29.7	24%
9%	115.5	126.3	91%	17.5	43.0	41%
10%	133.9	117.3	114%	36.5	52.1	70%
6%	148.3	237.1	63%	15.4	35.1	44%
0%	0.0	0.0		0.0	0.0	
0%	0.0	0.0		0.0	0.0	
0%	0.4	0.0		0.3	0.0	
0%	9.4	0.0		1.3	0.0	
49%	**943.3**	**1502.6**	**63%**	**1260.0**	**1735.2**	**73%**

Compact totals are approximate and displayed net of any amounts de-obligated.

Estimating Compact **Beneficiaries and Benefits**

Under MCC's results framework, beneficiaries are defined as an individual and all members of his or her household who will experience an income gain as a result of MCC interventions. We consider that the entire household will benefit from the income gain and counts are multiplied by the average household size in the area or country. The beneficiary standard makes a distinction between individuals participating in a project and individuals expected to increase their income as a result of the project. Before signing a compact, MCC estimates the expected long-term income gains through a rigorous benefit-cost analysis. MCC may reassess and modify its beneficiary estimates and/or the present value of benefits when project designs change during implementation.

Projected Beneficiaries and Income Benefits by Compact.[1]

Compact	Estimated Number of Beneficiaries	Estimated Long Term Income Gain Over the Life of the Project (PV of Benefits)[2]	Benefit/ Cost Ratio[3]
Armenia	426,000	$295,500,000	1.7
Benin	14,059,000	$409,600,000	1.8
Burkina Faso	1,181,000	$156,300,000	0.5
Cape Verde I	385,000	$149,500,000	1.8
Cape Verde II	604,000	$148,200,000	1.6
El Salvador	795,000	$366,700,000	1.0
Georgia	143,000	$301,300,000	1.0
Ghana	1,217,000	$690,300,000	1.7
Honduras	1,705,000	$237,300,000	1.5
Jordan	3,657,000	$800,300,000	4.1
Lesotho	1,041,000	$376,000,000	1.5
Madagascar	480,000	$123,200,000	1.7

Compact	Estimated Number of Beneficiaries	Estimated Long Term Income Gain Over the Life of the Project (PV of Benefits)[2]	Benefit/ Cost Ratio[3]
Malawi	4,484,000	$2,209,300,000	9.2
Mali	2,837,000	$393,600,000	1.2
Moldova	414,000	$259,900,000	1.5
Mongolia	2,058,000	$314,800,000	1.7
Morocco	845,000	$907,200,000	1.8
Mozambique	3,325,000	$542,300,000	1.5
Namibia	1,063,000	$240,500,000	1.1
Nicaragua	118,000	$83,500,000	0.9
Philippines	125,822,000	$483,300,000	1.6
Senegal	1,662,000	$863,300,000	2.2
Tanzania	5,425,000	$1,335,800,000	2.6
Vanuatu	39,000	$73,800,000	1.4
Total for All Compacts[4]	**173,787,000**	**$11,761,500,000**	**1.9**

NOTES:

1. These estimates do not include the projected beneficiaries of projects or activities that have been terminated or suspended by MCC (Madagascar, Honduras, Nicaragua, and Armenia). In the case of Madagascar, the estimates account for the compact's early termination.
2. The Present Value (PV) of Benefits is the sum of all projected benefits accruing over the life of the project, typically 20 years, evaluated at a 10 percent discount rate. Estimates are reported in millions of US$ in the year that the ERR analysis was completed. Because the PV of benefits uses a discount rate, these figures cannot be compared directly to the undiscounted financial costs of MCC compacts, but must be compared to the PV of costs instead.
3. The benefit/cost ratio is calculated by dividing the PV of benefits by the PV of costs. The PV of costs is the sum of all projected compact costs evaluated at a 10 percent discount rate.
4. Column totals may not equal the sum of the individual rows due to rounding.

Compact Completions during Fiscal Year 2012

BENIN

MCC and the Government of Benin recognized that a poor investment climate and lack of dynamic private sector activity impeded sustainable economic growth and poverty reduction. The compact sought to address problems related to insecurity of property rights, lack of access to capital, an inefficient judicial system, and a lack of competitiveness at the Port of Cotonou, all of which constrained investment and economic growth. The five-year, $307 million compact was signed in February 2006, entered into force in October 2006 and ended in October 2011.

POLICY REFORMS

- Passage of the rural landholding law in October 2007 has been a key step in developing the legal and policy framework for strengthening property rights in Benin.
- The 2007 National Microfinance Policy complements other compact projects by articulating the government's commitment to ensuring that financial services are accessible to low-income households and micro enterprises, enhancing the professional status of this sector and improving its integration into the financial sector.
- The Code of Civil, Commercial Administrative and Social and Accounting Procedure was enacted in February 2011 to modernize the procedural rules of courts, speeding case processing and enhancing efficiency in the justice sector. The code went into effect on February 28, 2012.
- MCA-Benin supported the passing of decrees creating the new Business Registration Center management and regulating formalities required for business registration and operation.
- The government took numerous steps at the Port of Cotonou to reduce corruption and receive certification under the International Ship and Port Facility Security Code.

OUTPUTS

- The Port of Cotonou is now expanding its capacity, improving security and increasing efficiency due to MCC-funded assistance. Modernized port services and investments by a competitively selected private port operator are making a significant contribution to Benin's long-term economic growth potential. Fees from the private sector concessionaire will allow the Port Authority of Cotonou to make additional investments to supplement the MCC project.
- Average time for treating an application for microfinance institution authorization is 42 days, down from 90 days in 2006.
- 294 rural communities had approved rural landholding plans.
- Improved case management systems and a complete overhaul of Benin's outdated civil procedures code, new primary courthouses, a Legal Information Center, and a new court of appeals should reduce the time and cost of enforcing contracts and improve the overall efficiency and quality of the judicial system. MCC's support completed the construction of five new courthouses. These investments in the justice system, along with improvements in alternative dispute resolution and in streamlining and modernizing the process for formal business registration, are important steps toward improving the business climate in Benin.

PRELIMINARY OUTCOMES AND EXPECTED IMPACT

- The Port of Cotonou is a key trading hub for neighboring countries, including Niger, Mali, Nigeria, and Burkina Faso, and is the driver of economic growth in Benin. By the end of the compact, the volume of merchandise flowing through the port increased from 4 million metric tons in 2004 to nearly 7 million metric tons in 2010. Over the next 20 years, increased growth resulting from MCC's investments is expected to benefit the country's entire population.

SUSTAINABILITY AND PARTNERSHIPS

- MCC and the European Union collaborated in developing and implementing judicial reform projects from the start of the compact to avoid duplication, maximize value and influence Government of Benin policy reforms.
- The Government of Canada launched a program supporting the microfinance sector in Benin, including a component designed to follow and continue MCC's work with the Ministry of Finance's Microfinance Supervision Unit.
- Requiring the concession management of the MCC-financed operating terminal at the south wharf, and requiring the concessionaire to make complementary investments, are important factors in the sustainability of the port investments.

GHANA

The Government of Ghana focused its MCC compact on increasing the production and productivity of high-value cash and food staple crops in certain areas of Ghana and on enhancing the competitiveness of Ghana's export base in horticultural and other traditional crops. The five-year, $547 million compact was signed in August 2006, entered into force in February 2007 and ended in February 2012.

POLICY REFORMS

- Ghana's parliament passed landmark legislation in June 2010 to promote access to improved seed varieties, certified fertilizer and pest-free plant material. This current law, which took 12 years to pass, brings Ghana's legislation into conformity with the protocols of the Economic Community of West African States on these issues, opens up the opportunity for higher yielding varieties to be used in Ghana and helps support the modernization of Ghana's agriculture sector.
- The Lands Commission Act, Act 767, 2008 was published in the Government of Ghana Gazette on December 12, 2008 to restructure the five public land sector agencies into a single agency.
- The Axle Load Policy was approved by the Cabinet and an official action plan prepared. The new Road Traffic Regulation has incorporated the requirements of the policy and the action plan.
- The Policy on Fuel Levy was approved by the Cabinet to ensure a sustainable road maintenance regime.

OUTPUTS

- 250 school blocks were rehabilitated and constructed.
- 66,930 farmers were trained in commercial agriculture.
- 5,729 land parcels have been surveyed, and 1,481 land parcels have been registered.
- Investments in post-harvest infrastructure have resulted in installing 10 cooling facilities.
- Nearly 14 kilometers of the N-1 highway—renamed the George Walker Bush Motorway—were rehabilitated to link Accra, the capital city, with a major port, the international airport and the country's major agricultural regions.
- Over 357 kilometers of feeder roads have been completed in rural areas, linking them to markets and social service networks.
- 134 rural banks across Ghana have been connected to the national payment system through a satellite-based wide area network.

PRELIMINARY OUTCOMES AND EXPECTED IMPACT

- As of March 2012, the N-1 highway is facilitating the effective movement of 51,055 vehicles per day and expediting the transport of perishable high-value horticultural exports by reducing travel time at peak hours from 60 minutes prior to construction in 2009 to 19 minutes on the nearly 14 kilometers of MCC intervention and reducing wear on vehicles from rough roads. The number of vehicles per hour at peak hours has increased slightly from 4,021 to 4,078. Annualized average daily traffic has increased greatly from 27,737 to 51,055.
- Enrollment in all schools affected by the education activity increased from 37,733 prior to commencement of construction in 2009 to 41,019 at compact closeout.
- The construction of 392 water points, including boreholes, pipe extensions and small-town water systems, was intended to improve health and reduce the incidence of illness and loss of productivity due to unsafe drinking water and reduce the time and effort spent fetching water. Prior to construction in 2010, the distance from a potable water source was an average of 1,190 meters. Following completion of the activity, the distance had been reduced to 522 meters.

SUSTAINABILITY AND PARTNERSHIPS

- MiDA (or the Millennium Development Authority that implemented Ghana's MCC compact) attracted VegPro, a Kenyan vegetable exporting company known for working with small and mid-size farmers, to the irrigation scheme in the southern region. VegPro secured the lease of 1,050 hectares adjacent to the hectares that will be served with the MCC-financed irrigation perimeter. VegPro will source some of its vegetables from MiDA-trained farmers, who receive water from the irrigation scheme. VegPro also will potentially employ up to 800 people on its 1,050-hectare farm. MiDA is working with Syngenta, a Swiss company, to provide agricultural inputs for farmers served by the irrigation scheme in the southern region. Working with these two companies helps to ensure the sustainability of MCC's irrigation investment.
- MCC, MiDA and the UN World Food Program (WFP) identified opportunities for MCC-funded farmers to be suppliers for WFP's Purchase for Progress initiative. This innovative program is designed to respond to food security needs in developing countries by providing a structured market for smallholders as they transition to commercial agriculture. WFP is purchasing grain from MiDA-trained farmers through two grain buyers linked to the compact program.

EL SALVADOR

MCC and the Government of El Salvador focused the compact on improving the lives of Salvadorans through strategic investments in education, public services, agricultural production, rural business development, and transportation infrastructure. The largest of the compact's components, the Transportation Project, unified El Salvador's Northern Zone with the rest of the country, enabling new economic opportunities for rural households, lowering transportation costs and decreasing travel times to markets. The five-year, $461 million compact was signed in November 2006, entered into force in September 2007 and ended in September 2012.

POLICY REFORMS

- El Salvador´s legislature passed a decree that enabled the transfer of revenues from traffic fines, license plates and other fees directly to the national road maintenance fund. This decree significantly increased the prospects for sustainability of the road system through appropriate road maintenance.

OUTPUTS

- Over 33,000 households have benefited from a connection to the electricity network.
- MCC improved the access of 7,634 households to improved water and of 7,190 households to improved sanitation.
- MCC funded the construction, rehabilitation and/or equipping of 22 educational facilities, with 30,632 students participating in MCC-supported educational activities.
- MCC funding has assisted about 17,500 producers by providing training, seeds, equipment, and technical assistance. MCC funding has supported work to improve 25,400 hectares under production on which producers have planted short-season vegetables and fruits and improved pasture lands.
- The FIDENORTE investment program has granted 44 loans to small- and medium-sized businesses in the Northern Zone to develop new projects in agriculture, tourism and handicrafts, amounting to more than $7.5 million.

PRELIMINARY OUTCOMES AND EXPECTED IMPACT

- MCC financed the rehabilitation and construction of more than 220 kilometers of road (equivalent to the distance between Washington and Philadelphia), three large bridges and 20 smaller bridges in northern El Salvador to help improve connectivity with the rest of the country. This east-west highway in the north stretches close to the borders with Guatemala in the west and Honduras to the east, and the improvements are anticipated to reduce travel time by 50 percent (12 hours to six hours).
- Based on the preliminary findings of an impact evaluation, within one year of receiving assistance, dairy farmers increased their annual productive income by an estimated $1,850 on average compared to those who did not receive assistance. These farmers sold a larger volume of milk and more secondary dairy products than farmers who did not receive assistance, even when controlling for their baseline sales. Handicrafts producers did not realize an increase in income compared to producers who did not receive assistance. However, on average, each artisan receiving assistance employed over one month of additional full-time labor relative to those who did not receive assistance.

SUSTAINABILITY AND PARTNERSHIPS

- FOMILENIO (which implemented El Salvador's MCC compact) and the Kriete Foundation agreed to continue support for young people through the scholarship program.
- MCC is committed to funding sustainable projects, and Salvadorans in the Northern Zone will have reliable access to electricity thanks to a public-private partnership between the Government of El Salvador and AES Corporation. The contract required AES to ensure all operations and ongoing maintenance of the transmission lines in accordance with local law and industry best practice.
- In partnership with Super Selectos, a national chain of grocery stores, USAID provided a Global Development Alliance grant of $500,000 to El Salvador Produce, a commercial cooperative society composed of 20 fruit and vegetable producer organizations established with the support of the MCC-funded Productive Development Project. The grant was used to build cold-storage and transport for the commercialization activities of El Salvador Produce.

Results in **Agriculture and Irrigation**

210,851
farmers trained

3,551
enterprises assisted

117,150
hectares under improved or new irrigation

181,994
hectares under production

$83.8
million in agricultural and rural loans

Results as of September 2012

Armenia. Margarita Grigoryan.

IRRIGATING A PATH TO PROSPERITY

Margarita Grigoryan, a farmer in the Armenian town of Khoronk, used to support herself and her family on an agricultural income of about $1,000 per year. Prior to MCC's investment, Margarita grew wheat and other low-value crops. Yet, her income was insufficient to provide for her family, and her ability to expand operations and increase her income was limited by an unreliable canal to irrigate her crops.

That was until Armenia's MCC compact overhauled the country's agricultural sector by improving irrigation infrastructure, training farmers, providing access to credit, and strengthening water user associations.

While she once described the canal that irrigated her land as nothing more than broken pipelines with significant water shortfalls, Margarita now celebrates a rehabilitated canal that works. "I now can plan my growing season more effectively because I have confidence that my farm will receive an appropriate amount of water on a predictable schedule," she said. Because of the compact, Margarita and other farmers benefited from loans and training in advanced agricultural practices. Margarita applied for a loan to set up her own greenhouse, where she is growing cucumbers and green beans that helped her double her annual crop production.

Today, Margarita's income increases make it possible for her to provide for her family and grow her business. The Irrigated Agriculture Project is projected to generate an average increase of 150 percent in farmers' incomes over 20 years from a baseline of $310 per year.

Results in **Roads**

El Salvador. Raul Armando Vaquero.

ACCESSING OPPORTUNITY

For the past 35 years, Raul Armando Vaquero, a dairy farmer from the small town of Cuyuiscat in El Salvador's Northern Zone, needed a horse and carriage to transport the cheese and milk he sold to customers around Metapán. In winter, swollen rivers prevented Raul and his employees from even reaching markets.

Today, Raul faces a different reality. The construction of the Northern Transnational Highway, funded through El Salvador's $461 million MCC compact, has created unprecedented opportunities for the residents of the Northern Zone, including dairy farmers like Raul. The Northern Zone historically has been cut off from the rest of the country, contributing to widespread poverty that affects more than half of the region's families.

MCC has financed the rehabilitation and construction of more than 220 kilometers of road—equivalent to the distance between Washington and Philadelphia—along with 23 bridges. This east-west highway, which connects to major border crossings with Guatemala and Honduras, allows cargo to be transported more easily. It allows the people living in the Northern Zone to readily access social services and jobs.

With the convenience of the Northern Transnational Highway, Raul now has access to markets in the winter and has significantly reduced delivery time in all four seasons. He can drive to Nueva Concepción, a larger city with bigger markets, and deliver a fresher, higher quality product. "We now live in a new Northern Zone," said Raul. "We are now living in a land of opportunity."

4,646.8
kilometers of roads under design

3,005.5
kilometers of roads under works contracts

1,712.1
kilometers of roads completed

Results as of September 2012

Results in **Property Rights and Land**

70
legal and regulatory reforms adopted

20,757
stakeholders trained

5,738,809
rural hectares mapped

1,514,818
rural hectares formalized

210,445
urban parcels mapped

38,712
urban parcels formalized

Results as of September 2012

Lesotho. Villagers from Khubetsoana.

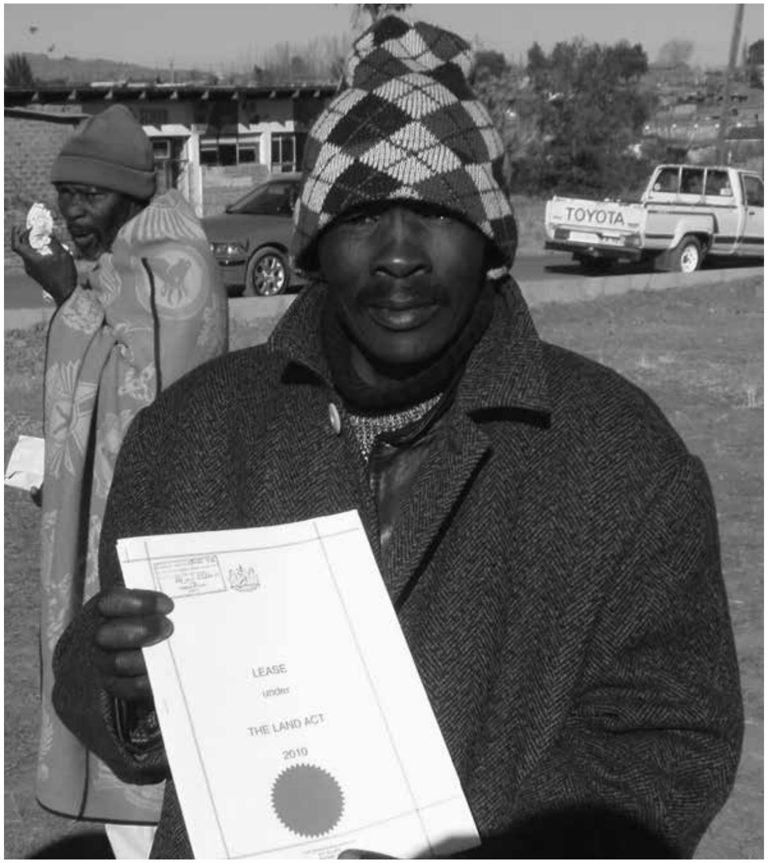
SECURING TITLE TO A BETTER FUTURE

Residents from Khubetsoana face a more secure future because of the security of a land title.

Until now, tens of thousands of people have lived on unregistered land plots in unplanned settlements around Maseru, the capital of Lesotho. Formal procedures to access land were difficult to navigate, forcing many citizens simply to occupy land or purchase it informally to construct housing.

Part of MCC's $363 million investment in Lesotho is changing this bleak reality and reforming the country's land sector by registering and surveying urban land parcels. The compact incentivized major policy changes in the legal and regulatory framework for land administration to sustain these reforms, including a new Land Act that sets out regulations to improve tenure security, provide market-value compensation in case of expropriation and establish the legal basis for land regularization and titling in informal settlements. Because historic legal changes in Lesotho removed the minority status of married women, joint land titling is now possible too. This is an important step forward for gender equality and economic development.

For the communities that live around Maseru, including villagers from Khubetsoana, these reforms toward more secure property rights are making a difference as they receive formal leasehold titles to land for the first time. And Basotho are using their land titles as collateral to access credit and other services, paving the way to economic growth and self-sufficiency. Between 50,000 and 75,000 households could potentially benefit.



Results in **Water and Sanitation**

Ghana. Residents of Chanzeini.

BENEFITING FROM SAFE, CLEAN DRINKING WATER

The residents of Chanzeini, a village in the Tamale area of northern Ghana, long struggled without access to safe drinking water. For years, women and children had to cross a busy highway to fetch water. They then stepped barefoot into the reservoir's muddy water, often next to livestock, potentially exposing themselves to the devastating Guinea worm disease.

Part of Ghana's $547 million MCC compact helped change that by promoting awareness and eradication of Guinea worm in the north, training water and sanitation officers and expanding access to potable water in rural areas. Because of this investment, Chanzeini's residents are now using a standpipe to draw safe, clean drinking water. Relieved of the daily burden of traveling far to fetch water, they now have more time to devote to work and studies. They are no longer forced to drink dirty water, and their health is improving as they avoid water-related infectious diseases. Women and children no longer risk injury by crossing a busy highway to fetch water. In total, the MCC compact funded the construction of 392 water points in Ghana, including in Chanzeini.

$36.1
million in feasibility and/or detailed design contracts signed

$440.1
million in construction contracts signed

10,674
persons trained in hygiene and sanitary best practices

852
water points constructed

11,756
sanitation systems constructed

Results as of September 2012

Results in **Education**

830
educational facilities constructed, rehabilitated and/or equipped through MCC-supported activities

1,734
instructors trained or certified through MCC-supported activities

298,254
students (any educational level) participating in MCC-supported educational activities

33,381
additional primary/secondary/tertiary school female students enrolled in MCC-supported educational facilities

29,953
primary/secondary/tertiary/vocational school graduates in MCC-supported educational facilities

Results as of September 2012

Namibia. Tunomukwathi Angula.

TRANSFORMING TRAINING INTO A DREAM JOB

"A dream come true!" Those were Tunomukwathi Angula's emotional words when she received her tour-guide certificate. The 26-year-old woman is one of 47 Namibians who successfully completed a training course funded by MCC that allows graduates to lead tourist groups through the country's deserts and national parks. The class included 13 women as well as members from the Ovahimba, a vulnerable indigenous minority group.

For 14 months, Tunomukwathi and her classmates learned a variety of skills for working in the tourism industry. They studied crucial topics like English, flora, fauna, and geology. During their skills and competency training, the students needed to prove themselves in their future professional environment by working for three months in Namibia's vast rural areas, surrounded by beautiful landscapes and abundant plants and animals.

Within two weeks of her graduation, Tunomukwathi received a job offer with a Namibian tour operator. Almost half of the students in her class found employment with Namibian tour operators either during the course of the training or within weeks of its completion.

The grant that trained Tunomukwathi and other students is part of Namibia's $304.5 million MCC compact. The compact's Education Project is linked to the Tourism Project, which aims to improve the management and infrastructure of Etosha National Park, enhance the marketing of Namibian tourism and develop the capacity of communal conservancies to attract investments in ecotourism and increase revenues. MCC is investing in the Namibian tourism sector—the country's second-most lucrative industry after mining—because of its potential to drive economic growth and reduce poverty. The Tourism Project is expected to benefit more than 168,000 people and raise household income almost $44 million over the next 20 years.

Results in **Energy**

Tanzania. Martha Besisila.

POWERING ECONOMIC GROWTH

Many Tanzanians struggle to turn on the lights. Less than one in five households is connected to the electrical grid, which experiences frequent blackouts and power surges. This cripples businesses and households. For some villagers in Hogoro in the Dodoma region, however, the reality is far brighter. An American company worked with MCC and the Government of Tanzania to make sure the lights come on and stay on. Pike Electric, of Mount Airy, North Carolina, competed for and won an MCC-funded contract valued at $17.9 million to install power lines, part of MCC's $206 million investment in Tanzania to rehabilitate and expand the nation's power grid.

This means Martha Besisila's home in Hogoro is now connected to electricity for the first time. Pike Electric is constructing approximately 250 miles of transmission lines in Dodoma. As Pike completes sections of low voltage lines through its MCC-funded contract, new customers are lining up in TANESCO's office, the national electricity utility company, to request a connection. For Martha (second from the right)—and other households like hers benefiting from the lines Pike installed—gone are the days of kerosene lanterns, candles and generators spewing diesel exhaust.

Pike's role in lighting the way to a reliable power supply for Martha and her neighbors is helping reduce poverty and promote economic growth. Reliable electricity creates a healthier alternative to charcoal and other fossil fuels, generating environmental and social benefits. It allows entrepreneurs to start and grow small businesses. And it gives students the option of studying at night.

over **8** *million*
estimated number of beneficiaries who will benefit from MCC's energy investments just in Tanzania, El Salvador, Ghana, Mongolia, and Malawi

over **33,000**
households in El Salvador benefiting from a connection to the electricity network

1,950
households in El Salvador benefiting from access to isolated solar systems

3,000
kilometers of new electricity lines MCC will finish constructing in Tanzania in 2013, which are expected to impact nearly 1.5 million beneficiaries

Results as of September 2012

CONTINUOUSLY LEARNING TO IMPROVE THE MCC MODEL FOR DEVELOPMENT EFFECTIVENESS

EXCELLENCE AT MCC MEANS LEARNING AND ADAPTING IN ORDER TO DO WHAT WE DO BETTER.

From promoting good governance to launching a redesigned Threshold Program, empowering our partner countries, focusing on results, and sharing what we have discovered along the way, MCC demonstrates a firm commitment to learning and improving what we do in order to make U.S. development assistance as effective as possible.

REFINING THE COMMITMENT TO GOOD GOVERNANCE

Modernizing the country selection system to further incentivize governance reform: In fiscal year 2012, MCC made some changes to our annual country selection process to take advantage of expanding data related to economic and political governance, new findings in economic growth literature and lessons from our initial years. We reaffirmed our commitment to using third-party data to assess countries' policies in the categories of Ruling Justly, Investing in People and Economic Freedom but refined our scorecard in several key ways. First, MCC took advantage of innovative data in the fields of Internet freedom, access to credit and gender equality to add new indicators to the scorecard. Second, we strengthened the U.S. Government's commitment to promoting democratic rights by adding a hard hurdle related to political rights and civil liberties. Third, we incorporated economic findings that suggest there is not one "recipe" for economic growth by allowing for more flexibility within the scorecard while still maintaining the emphasis on competition and selectivity.

After our first year using the new scorecards, we have already seen results. Freedom House reports an increase in the number of foreign governments requesting guidance on how to strengthen press freedom. Several countries, such as Côte d'Ivoire, Sierra Leone, Senegal, and Niger, are working with the International Finance Corporation to assess or eliminate legal restrictions against women's participation in their economies. Across the board, the new scorecards have given the U.S. Government, MCC and our indicator institutions increased opportunity to discuss policy performance with foreign governments eager to compete for MCC eligibility.

Holding partner countries accountable: Fiscal year 2012 was unique in that it demonstrated the full spectrum of how MCC approaches selectivity in compact country partnerships. In two very different circumstances, MCC demonstrated how to hold countries accountable for maintaining a commitment to democratic governance.

In late March 2012, the military in Mali seized control of government buildings and forced the democratically elected government from office. Mali's MCC compact was mere months from completion, but in keeping with our commitment to partner only with countries that uphold democratic governance, we began the termination process almost immediately. Acting with due regard for the intended beneficiaries, MCC pursued a responsible, orderly wind-up of all projects. Families participating in the irrigation program were protected from the negative consequences of an early ending, but the shell of an unfinished airport terminal in Bamako will stand as a reminder of what might have been in the absence of the military coup.

A SNAPSHOT FROM MALI

"There is currently a large American organization helping Mali to put an end to poverty, difficulty and suffering, in a place called Alatona. Some people dared to say that Alatona had become paradise. Thank you, MCA-Mali, for achieving something that makes all Malians happy. Thank you, MCA-Mali, for helping the poor; this continued to when it was time to start farming. They brought money for plowing. They brought money for planting. They brought money for weeding. They brought money for cutting the rice for harvest. Each home you visit you think is better than the one before, because you find contentment and happiness and joy and calm and peace and laughter and people eating food they like and as much as they want. How can we say thanks to MCA-Mali who have done something the likes of which has never been seen in Mali since independence? Thank you, MCA-Mali, for keeping your promises. Thank you, MCA-Mali, for doing good work."

Excerpt from a letter of appreciation dated February 11, 2012, by Aburu Sabu Sangare, an Alatona resident who benefited from the compact's irrigation project implemented by MCA-Mali. The letter, which was written prior to the coup that led to the termination of Mali's compact, shows enthusiastic support for the work then in progress.

By contrast, the experience with Malawi shows how holding countries accountable for good governance can contribute to policy reform. Fiscal year 2012 began with Malawi's compact on hold due to concerns about the negative trends in democratic governance in that country; in March 2012, MCC suspended Malawi's $350 million compact. When President Banda came to office following the death of President Mutharika, she declared she would address the concerns that had led MCC to suspend the compact. By June 2012, we had witnessed new laws, new patterns of action, respect for human rights, and a stronger, more consistent economic policy. As a result, MCC's Board reinstated Malawi's compact, demonstrating that with political will and purposeful action a country can restart an MCC compact.

Incentivizing policy reforms during compact development and implementation: A commitment to sound policies drives not only MCC's country selection but also increasingly the development and implementation of compact programs. The constraints to economic growth analysis for **Ghana's** proposed second MCC compact, for example, was done within the context of the U.S.-Ghana Partnership for Growth, which emphasizes the importance of strong policies and institutions for economic growth. The constraints analysis, conducted jointly by Ghanaian and U.S. Government economists, identified the unmet demand for reliable power as a binding constraint to growth. Subsequent analysis found that without sector-wide and institutional reforms, further investments in infrastructure would not be sustainable and the deterioration of sector assets would continue. This analysis prioritized a set of institutional, regulatory and structural reforms for the sector, as well as steps to increase the operational efficiency of key power sector entities. Due to the clear messages and joint analysis about the role of reforms in improving Ghana's access to reliable power, institutional and policy issues have formed the centerpiece of consultations with stakeholders and will be the anchor of Ghana's MCC compact.

In **Moldova**, two examples of policy and institutional reform include the Water User Association Law (2010) and the Water Law (2011), both of which are critical to the compact's Transition to High-Value Agriculture Project. These two laws, which have been passed and implemented, provide Moldova with the policy framework to support the sustainability of the soon-to-be rehabilitated irrigation systems as well as enhance the country's overall water resource management. With regard to the Water User Association Law, MCC and the Moldovan team concluded that the sustainability of the irrigation systems to be rehabilitated through the MCC compact would best be served by placing responsibility for their management in the hands of end-users, rather than having the state-owned water agency continue to play that role. The new Water User Association Law transfers responsibility for the operation and maintenance of state-owned irrigation systems to water user associations, clarifies the rights and responsibilities of these associations and includes the need to set cost-recovery tariffs. The approach has been embraced by the state-owned water agency and applied to other irrigation systems. With regard to the Water Law, the sustainability of high-value agriculture depends on reliable water resources. MCC used climate modeling to identify the risk of climate impacts on water availability over the long term. The lack of water resource planning and monitoring added to this concern. MCC assisted the Government of Moldova in developing a modern Water Law based on a system of water rights and integrated water resource management.

APPLYING THE NEW THRESHOLD PROGRAM

A targeted policy focus: During fiscal year 2012, MCC began implementing the redesigned Threshold Program with four countries—Tunisia, Honduras, Niger, and Nepal. For these countries, participation in the new Threshold Program represents an opportunity, as well as a challenge, to demonstrate their commitment to the policy areas underlying MCC's eligibility indicators, specifically Ruling Justly, Investing in People and Economic Freedom. Through the Threshold Program, MCC will support our partners' efforts to undertake policy and institutional reforms to address their binding constraints to growth. The program will place the responsibility for design and implementation on our partner countries and will be based on rigorous analytical work, beginning with a constraints analysis. A country's performance under the Threshold Program will help to inform compact eligibility decisions, as these programs will provide information to MCC's Board of Directors about a country's ability to implement critical reforms and on MCC's opportunity to reduce poverty and stimulate long-term growth.

Definition: **Threshold Program**

Refers to country-driven partnerships that assist countries in becoming eligible for an MCC compact by supporting policy and institutional reforms that target binding constraints to economic growth

Before the launch of the new Threshold Program, MCC financed 23 Threshold Programs in 21 countries, totaling nearly $495 million. Eight of these countries were selected as compact-eligible and signed compacts.

BUILDING CRITICAL COUNTRY CAPACITY

Putting MCAs front and center: Beyond compact investments that help the poor, an often overlooked benefit of MCC's operations is how we contribute to building the capacity of a core group of country nationals, the MCAs and implementing entity staff. These professionals are provided with a unique opportunity and resources to implement large-scale development projects, address practical challenges firsthand and become experts in the field within their own countries and the region.

For example, MCC's contribution to the human capital of our partner countries was highlighted during the 2012 annual conference of the International Association of Impact Assessment (IAIA) in Porto, Portugal. The IAIA is the leading global network on best practices in the use of environmental and social impact assessment for decision-making on policies, programs, plans, and projects. MCA representatives from Lesotho, Senegal, Mali, Morocco, and Mozambique attended this global conference and presented case studies that highlighted the successes and challenges they encountered as part of their work with MCC. The sessions they led were well-attended, and the presenters demonstrated the valuable skills and expertise they brought to and refined through their work on MCC compacts. After their presentations, the MCA representatives were surrounded by practitioners from other countries, seeking advice and practical recommendations for challenges they face with their own development initiatives. Urging occasional participation in professional conferences such as IAIA is a way for MCC to encourage MCA representatives to take stock of what they have accomplished, expand their professional network and be recognized for their expertise. This empowers them to become even more effective at what they do in the context of the five-year MCC investment and beyond.

> *Definition:* **MCA or MCA entity**
> **Refers to the accountable entity in a partner country responsible for implementing the MCC compact**

MCC also helps translate professional capacity building into institutional capacity building in partner countries.

- The Gender Equality and Economic Rights Activity in **Lesotho's** compact works to sustain the rights women achieved with the passage of the Legal Capacity of Married Persons Act. MCA-Lesotho worked closely with the Ministry of Gender and Youth to develop a sustainability plan that will change the ministry's role in relation to other ministries and civil society to engage in policy reviews and institutional reforms throughout the country. Building the capacity and expanding the role of the Ministry of Gender and Youth is helping promote gender equality in Lesotho well beyond the life of the compact.
- In **Morocco**, we see the government applying the MCC model—transparency, accountability, a focus on results, and standard-setting—to its own operations. The Minister of Agriculture and Maritime Fisheries, for example, described the Morocco Compact's Fruit Tree Productivity Project as the Government of Morocco's model for farmer aggregation. The Minister of Finance and Economy credited MCC on several occasions for inspiring participative public consultations in the design and implementation of newer Moroccan government programs. And the Minister of Handicrafts is bringing MCC's high standards on social and environmental impact assessment to bear in broader Moroccan government investments.
- Residents of rural areas in **Ghana** have poor access to basic community services such as potable water, sanitation, schools, and electricity. In the past, community services were delivered through the central government's direction, with little input from local governments or beneficiaries. In the last few years, however, the government committed to a decentralization strategy to empower local governments and beneficiaries in the hopes of delivering community services more efficiently. A major obstacle to successfully implementing this strategy is a lack of adequately trained specialists in local governments. Lack of capacity at the local level to conduct public procurement results in leakage, misuse and suboptimal use of public resources. To address this issue, the Ghana Compact's Procurement Capacity Activity was designed to strengthen the capacity of various procurement entities within the Ghanaian government to procure necessary goods, works and services with greater economy, efficiency and effectiveness. To this end, an extensive training program on international standards was developed and implemented. Five institutions of higher learning and three training institutions incorporated the training materials created through the activity in their curriculum, and 163 students from these institutions already completed one year of courses. Additionally, more than 1,250 potential procurement professionals completed internships in public service institutions, leading to job opportunities for more than 200 interns. The Procurement Capacity Activity was undertaken through an agreement with the Public Procurement Authority, which is continuing the activity after the compact ended.

Building stronger monitoring and evaluation (M&E) capacity: M&E capacity in our partner countries is strengthened through working closely with MCAs and implementers to comply with MCC's rigorous standards of monitoring and evaluation. In many countries, MCC's focus on results is a new way of doing business, so the standard M&E budget template for all compacts includes M&E training. This is to ensure that project implementers in partner countries learn about and are able to use best practices in M&E during the compact and in their jobs after the compact. Training materials on economic analysis, impact evaluation and M&E information systems have been developed for all countries to use. In-country trainings can be open to participants outside of MCA, including partner country government employees. In El Salvador, the president's unit for monitoring and evaluation sent staff to an MCA M&E training in preparation for their role in conducting monitoring post-compact after the MCA is closed. In addition, MCC regularly schedules "M&E colleges" for MCA counterparts to engage with us and one another on common challenges and best practices in collecting and reporting performance data as well as designing and conducting rigorous evaluations.

SHOWCASING AMERICA'S GENEROSITY

Respecting country ownership does not mean overlooking the need to recognize America's generosity in the field. In January 2012, MCC revised its strategy to ensure that all MCC-funded projects clearly and visibly acknowledge and communicate that MCC's investments are made possible through the generosity of the American people. The new branding guidelines make prominent use of the American flag and highlight MCC's core principles of country ownership and partnership. The key elements of the revised strategy are new MCA logo requirements (for compacts that enter into force or are signed after January 2012) that provide more consistency and a more prominent use of both the American flag and the country's flag, requirements for durable plaques on infrastructure and works projects, more clarity on roles and responsibilities within MCC and MCAs, and the required inclusion of marking and branding in MCA communications strategies.

	Country	MCA Name	Website
	Burkina Faso	MCA-Burkina Faso	http://www.mcaburkina.org/
	Jordan	MCA-Jordan	http://www.mca-jordan.gov.jo/
	Lesotho	MCA-Lesotho	http://www.mca.org.ls/
	Moldova	MCA-Moldova	http://mca.gov.md/?site=0
	Mongolia	MCA-Mongolia	http://www.mca.mn
	Morocco	Agence du Partenariat pour le Progrès	http://www.app.ma/

	Country	MCA Name	Website
	Mozambique	MCA-Mozambique	http://www.mca.gov.mz/en/
	Namibia	MCA-Namibia	http://www.mcanamibia.org/
	Philippines	MCA-Philippines	http://www.mcap.ph
	Senegal	MCA-Senegal	http://www.mcasenegal.org/
	Tanzania	MCA-Tanzania	http://www.mca-t.go.tz/

TRAVELING OUR RESULTS CONTINUUM

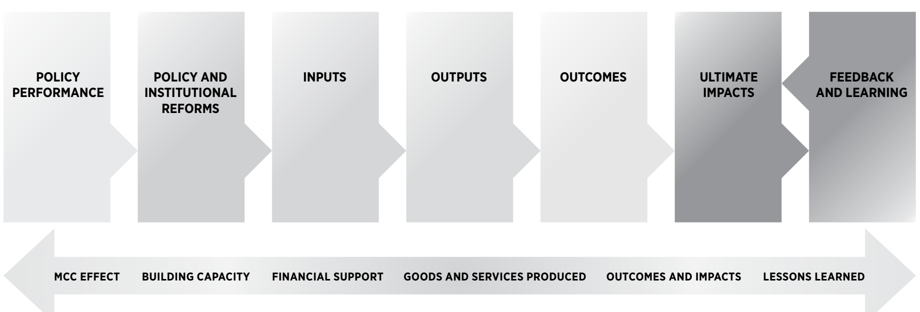
To set a new standard for aid effectiveness, MCC applies rigorous and transparent methods to measure that investments perform throughout the entire continuum of results.

We track **policy reforms** associated with our investments, like reforms to ensure that the roads we finance are maintained and that conditions are improved for a new business to formally register or get its products through customs.

We assess **inputs and outputs** that indicate whether projects are on track, like how much money we have invested in a given quarter and the number of farmers trained or the kilometers of new roads built.

We measure **outcomes** as programs reach completion, like increased traffic volume on improved roads—signaling more commerce—or if farmers are growing more high-value crops to sell.

And, because the ultimate result MCC is committed to producing and attributing to our programs is increased incomes among the poor, we turn to **independent impact evaluations** to determine if the income gains we seek are a direct result of our investments. We hire outside firms for these evaluations that apply scientific methods to determine if our investments actually did increase household incomes. In fact, since our inception in 2004, MCC has invested in over 120 independent evaluations, and more than 40 percent are rigorous impact evaluations. This commitment to incorporating impact evaluations of investments into operations establishes MCC as a recognized leader within the international donor community.



ADVANCING LEARNING AND ADAPTING PRACTICE

Putting principles into practice: MCC's model is based on a set of core principles essential for effective development assistance—good governance, country ownership, focus on results, and transparency.

The MCC Principles into Practice series, for example, offers a frank look at what it takes to make these principles operational. The experiences captured in this series inform MCC's ongoing efforts to refine and strengthen our model. Through the implementation of the U.S. Global Development Policy, which emphasizes many of the principles at the center of MCC's model, we hope this series allows others to benefit from and build on our lessons. For example, the World Bank designed its new Program-for-Results financing instrument in part on MCC's model. Program-for-Results links disbursements to achieving results that are tangible, transparent and verifiable. Program-for-Results specifically mentions MCC as a defining influence, drawing on such MCC lessons as the link between transparency, accountability and results and the distinct definitions of results during different times in the project cycle.

The Principles into Practice series also offers insights into MCC's experience with the technical and operational approaches we use to support poverty reduction through economic growth. Consistent with MCC's focus on results, we are committed to learning from our experiences and applying lessons learned to our programs. Consistent with MCC's commitment to transparency, and in the spirit of ongoing collaboration with other development practitioners, MCC will share this learning publicly, even when it reflects challenges that MCC and partner countries faced.

Ongoing learning in key practice areas includes:
Learning in Agriculture: MCC's willingness to invest in country-determined and integrated agriculture projects, which include large infrastructure elements, puts us at the forefront of promoting food security since the signing of our first compact in 2005. With the opportunity to set their own development priorities, 21 of 25 partner countries choose food security-related investments. By the end of the fiscal year, MCC's investments in agriculture, rural development and food security total approximately $4.4 billion among compacts that have entered into force. Together, these investments contribute significantly to the United States' global efforts to reduce poverty and under-nutrition, increase food security, empower women in agriculture, and promote climate smart/resilient agriculture.

We remain committed to learning and being held accountable for how well MCC's program outputs—such as farmers trained, loans disbursed, hectares under improved

TRANSPARENCY AND AID EFFECTIVENESS

The Fourth High Level Forum on Aid Effectiveness in Busan, South Korea, in late 2011 provided an important opportunity to elevate the international dialogue on the effective delivery of foreign assistance. MCC was part of the U.S. delegation to the forum, and our approach to development effectiveness took center stage. We showcased our work to deepen aid effectiveness by promoting country-driven strategies that reform policies, build stronger institutions and propel a comprehensive continuum of results from initial inputs to impacts. Reflecting a firm commitment to transparency, MCC publishes the economic analyses that inform our investment decisions, each compact's five-year budget, expected results, data on ongoing program progress, and our growing body of findings from independent impact evaluations as programs complete.

irrigation, and kilometers of roads built—ultimately translate into increased household incomes and well-being for beneficiaries. Independent impact evaluations are underway for MCC-funded agriculture investments that address issues such as changes in productivity, shifts to high-value agriculture, increased profitability of farm enterprises, and, ultimately, impacts on rural household incomes.

By the end of the fiscal year, MCC began preparing for the public launch of our first set of impact evaluations, marking an important milestone for MCC and one that showcases our commitment to results, accountability, learning, and transparency. These first evaluations focus on farmer training and technical assistance in the agriculture sector, covering approximately one-third of the agriculture investments in five countries—Armenia, El Salvador, Ghana, Honduras, and Nicaragua—and representing approximately 2 percent of MCC's total portfolio. This is the first set of completed MCC-financed independent impact evaluations for compact programs, and we are committed to applying the lessons learned from these early experiences to improve the design of future MCC projects and evaluations as well as share the findings widely in order to increase the effectiveness of development assistance more broadly. Key lessons include:

- Agriculture projects pose unique challenges for evaluation and often will require more time than originally allotted to evaluate changes in behavior, farm income and household income.
- Integrated projects with large infrastructure components (irrigation) have sequencing issues that must be monitored closely during implementation and evaluation and lagged impact issues for which realistic expectations about the timing of results must be established.
- Starter kits and other in-kind technical assistance must be considered carefully during program design to ensure that the content and delivery effectively target binding constraints to farmer behavior change.

PRINCIPLES *into* PRACTICE

The Principles into Practice series currently includes papers on:

- MCC's founding principles of country ownership and focus on results
- the technical areas of property rights and land policy and irrigated agriculture
- lessons learned through MCC's approach to gender equality in compact investments
- the challenges of and solutions for doing impact evaluations in the agriculture sector

The complete series is available at: *www.mcc.gov/principlesintopractice.*

- A randomized roll-out, where control groups are eventually treated within the compact period, as a compromise to a randomized controlled trial, where control groups are never treated, limits MCC's ability to go back after compact completion to further study impacts in a rigorous, conclusive way.
- Impact evaluations should address accountability issues and program impact and also include design elements that help us learn what program components worked and did not work for specific interventions—and why—to better inform the development of future compacts.

Securing Land: In consultation with their citizens, civil society and the private sector, 13 of MCC's 25 partner countries have sought MCC investments in property rights and land policy because of the central role that land, natural resources and other real property assets play in economic development. In many of these countries, land and property rights remain informal, and governments at national, regional and local levels lack the tools to effectively protect those rights and administer their land resources. MCC is leading the way in helping partner countries introduce a variety of legislative tools to formalize, protect and secure these informal rights. Through these efforts, our partner countries are demonstrating that informal rights can be conclusively identified and documented through careful design, careful planning, inclusive methodologies, copious work, and adequate time. By helping countries document and protect all land and property rights (including informal ones) and improving land governance at all levels down to the village, MCC is helping put in place one of the most fundamental tools for good land management and inclusive economic growth.

Building Infrastructure: MCC collaborates with partner countries to expedite the development and implementation of infrastructure projects. In Tanzania and Moldova, for example, road improvement projects have progressed from concept to feasibility studies, design, procurement, and construction. During program implementation, we continue to collaborate by maintaining significant contact with MCA project managers through regular calls, visits and training programs to identify risks and solutions to problems that arise during multi-faceted infrastructure projects. When a poor-performing contractor failed to meet significant milestones near the end of the compact, MCA-Benin, with MCC's assistance, was able to replace the problematic contractor with a superior one in less than four months in order to complete on time about $25 million in critical infrastructure improvements. In other countries, where project completion often takes more than five years, MCC's intensive involvement has accelerated works activities without sacrificing quality. This approach to infrastructure implementation support and oversight advances the effectiveness of our development assistance in both large and small construction programs.

Supporting Gender Equality: Since the unveiling of our 2007 Gender Policy, MCC has recognized that the distribution of growth outcomes matters and that poverty reduction depends on addressing the persistent gaps created by social inequalities. Good policy is not enough, however, and MCC has moved forward as a leader in gender integration through the implementation of Guidelines for Gender Integration. These guidelines provide explicit operational procedures, requirements and accountability mechanisms to ensure that gender is effectively integrated into compact processes and deliverables. For example, one new requirement is the social constraints to poverty reduction analysis, which a country completes following its constraints to economic growth analysis. In the development of Benin's second compact, economic analysis and social and gender assessment staff worked together on a matrix that maps out findings from both analyses and identifies the relationships between growth constraints by sector as well as gender and other social inequalities. Current MCC partner countries are also increasing their understanding and performance on gender integration. In April 2012, MCA-Mongolia received MCC's first Country Commitment Award for its achievements in gender integration in an early compact that did not benefit from gender analysis in design. Other countries are also using the guidelines as a tool to achieve more effective and equitable outcomes.

Enhancing Environmental and Social Performance: MCC's commitment to health, safety and the environment goes beyond upfront assessment and analysis of projects; it also looks to the long-term performance of MCC's investments in poverty reduction. Consistent with this commitment, we adopted the International Finance Corporation's Performance Standards on Environmental and Social Sustainability this year as an integral part of our approach to ensuring that the projects we support are environmentally and socially sound. In addition to providing a framework for managing environmental and social risks and establishing standards to protect the environment and people affected by the projects we support, adopting the IFC performance standards aims to improve project performance and enhance development outcomes. MCC's integrated approach to environmental and social performance starts by engaging partner countries at the earliest stages of project design and continues throughout compact implementation, involving stakeholders at all levels, from cabinet-level environmental ministries to implementers on the ground. Among MCC's partner countries, our work has strengthened government systems for environmental compliance, encouraged more efficient use and management of natural resources and contributed to an improved culture of worker health and safety.

CHANGING THE GLOBAL DEVELOPMENT CONVERSATION

MCC'S SIGNIFICANT CONTRIBUTIONS TO MAXIMIZE AID EFFECTIVENESS BENEFIT BOTH U.S. ECONOMIC INTERESTS AND THE DEVELOPMENT DISCIPLINE OVERALL.

MAKING DEVELOPMENT WORK FOR U.S. ECONOMIC INTERESTS

MCC: Gateway to Opportunity

MCC serves as a gateway to opportunity into next generation emerging markets in three tangible ways:

- **Through policies:** *The MCC "seal of approval" means partner countries are "open for business."* MCC creates enabling environments for trade and investment that make it easier for companies to expand into developing markets through pro-growth policy reforms (including stamping out corruption) and upgraded infrastructure (including roads and electricity grids).
- **Through partnerships:** *MCC helps build strong trading and investment partners.* Our goal is not only to help poor countries rise out of poverty but also to create stable trading and investment partners for the United States. MCC's approach aligns with Secretary of State Hillary Rodham Clinton's vision of 21st century economic statecraft—using diplomacy and development to create American jobs and boost the American economy. MCC's assistance is building the next generation of markets that want to buy American products and services.
- **Through procurements:** *MCC procurements can help U.S. companies access new markets.* MCC reaches out to American businesses to inform them of MCC-funded procurements, which are transparent and competitively bid.

According to **the *U.S. Global Leadership Coalition***, America's prosperity is linked with the global economy and dependent on trade and economic growth:

- 95 percent of the world's consumers live outside of the United States, and America's fastest growing markets—representing roughly half of U.S. exports—are in developing countries.
- More than one out of five American jobs is tied to trade.
- For every 10 percent increase in exports, there is a 7 percent increase in employment.

A Fit Approach

Well aware that the key driver of sustainable economic growth is the private sector, MCC continues to integrate the private sector into compact development and implementation. In May 2012, we renewed our commitment to integrating a private sector perspective in our work by adopting a new private sector strategy that builds upon our comparative advantages by developing improved processes to coordinate with companies, expanding staff responsibilities and exploring specific partnerships to catalyze greater private investment in partner countries. MCC's Finance, Investment and Trade (FIT) team is responsible for executing this strategy and serves as the hub for motivating and tracking private sector-related activity. Collectively, these efforts will strengthen the environment for private enterprise in MCC partner countries and integrate a business focus throughout the MCC program cycle.

The Investment Opportunity Assessment is a new tool to guide private sector engagement during compact development. It identifies when, where and how a partner country and MCC can engage the private sector around potential compact projects. This ensures that opportunities to positively impact private sector activity are explored and considered during compact development. In Ghana, for example, MCC is incorporating private sector views and expertise early in the development of that country's proposed second compact, including holding a roundtable and one-on-one sessions with businesses**.** MCC held a forum with the business community to explore potential investment opportunities through Benin's proposed second compact. In Georgia and El Salvador, businesses are helping shape the projects that MCC might fund, including identifying key constraints to economic growth and proposing innovative solutions—like public-private partnerships or co-investment mechanisms—to address those constraints.

Private Sector Strategy at Work

Examples of MCC's private sector strategy in action include:

- **Innovation Grant Program in Zambia:** The Zambia Compact supports a competitive grant and partnership program designed to identify and provide assistance for innovative partnership opportunities, particularly through private sector and market-driven approaches. The objective is to increase and sustain the poor's access to quality water and sanitation as well as improve water use, sanitation and hygiene practices among the poor. It is intended to strengthen tenure security and capacity for community-based planning. The program also provides significant access by women and vulnerable groups to project benefits and expands opportunities for entrepreneurship and income-generating activities related to water, sanitation and drainage.
- **As-Samra Partnership:** The expansion of the As-Samra wastewater treatment plant in Jordan is financed through a build-operate-transfer arrangement in partnership with the Samra Wastewater Treatment Plant Company Limited (SPC), a private company that built the existing plant and currently operates it under a concession from the Government of Jordan. Through this public-private partnership, a $93 million MCC

> *"MCC … we believe has created a very important process for evaluating countries and working with countries who want to go through political as well as economic reform. And, in fact, the Partnership for Growth … builds on the MCC analysis … So, we very much embrace the MCC approach and see it as a critical part of our overall development strategy."*
>
> —Michael Froman, Assistant to the President and Deputy National Security Advisor for International Economic Affairs, at an event at the Center for Global Development, July 31, 2012

grant and the Jordanian government's contribution help make the project both affordable to Jordan and financially attractive to SPC and local Jordanian banks, which are investing more than $100 million in private debt and equity funding for construction. This kind of public-private partnership helps ensure the long-term sustainability of MCC's investment in Jordan.

- **Lesotho Health Facilities Management/ICT PPP:** The Government of Lesotho and MCC are funding the refurbishment and reconstruction of up to 150 health facilities throughout the country and implementing various health informatics initiatives. These include an electronic national health informatics system, an electronic medical records system and an assets inventory and management system. To enhance the sustainability and impact of these investments, the Ministry of Health intends to bring in a private investor through a public-private partnership (PPP) to manage and operate the various facilities and to equip them with information and communications technologies (ICT), which will link the facilities to the rest of Lesotho's health system. The Government of Lesotho has engaged the International Finance Corporation as a transaction advisor to structure, tender and award this ICT PPP opportunity, which will complement the compact and expand the reach of MCC's investment. The PPP has the potential to transform Lesotho's health sector by facilitating e-health applications, embracing telemedicine and delivering modern medical services throughout the country.

PROMOTING DEVELOPMENT AS A PRINCIPLED DISCIPLINE

MCC: Influencing Policy and Practice

Promoting closer cooperation with the private sector is one way MCC is helping make development assistance more effective. In addition, by sharing lessons learned, offering expertise and steering the discussion in a number of hallmark initiatives, MCC is pushing new standards of excellence for the development discipline overall. Here's how:

- **U.S. Global Development Policy**: President Obama turned to MCC's key principles to develop a U.S. Government-wide global development policy, one that focuses on economic growth, selectivity, country-led planning, transparency, and accountability for results. Speaking before the United Nations, the President recognized MCC's influence: *"Building in part on the lessons of the Millennium Challenge Corporation … we will invest in the capacity of countries that are proving their commitment to development."*
- **Partnership for Growth (PFG)**: MCC's evidence-based decision-making, country selection process and technical expertise served as the foundation for PFG. This partnership between the United States and a select group of high-performing developing countries works to accelerate and sustain broad-based economic growth.
- **Feed the Future (FTF)**: MCC influenced the design and development of FTF's results and accountability framework. This involved defining core performance indicators to better monitor U.S. Government investments in food security and aggregate outcomes across countries and agencies. It meant coordinating whole-of-government reporting on global food security performance. It also entailed applying robust economic analysis during strategic planning and project design at USAID's Bureau for Food Security to emphasize rigorous impact evaluations of FTF food security investments so as to validate results, test causal pathways and generate evidence on the effectiveness of food security programs.
- **Transparency/Open Government efforts**: In June 2012, the managing director of Publish What You Fund said, *"The MCC joined USAID and the State Department to publish data on the Foreign Assistance Dashboard and is to date the only agency to publish obligation and expenditure data—setting a strong precedent for transparency in the U.S."*

> *"Through the MCC, the US has shown that it can deliver development co-operation that is in line with the principles on effective aid. In particular, ownership, predictability, untying, unearmarked funding, and a strong emphasis on results are key characteristics of MCC's approach."*
>
> —OECD Development Assistance Committee (DAC) Peer Review 2011

FINANCIAL STATEMENTS

Message from MCC's Chief Financial Officer

The Millennium Challenge Corporation is firmly committed to delivering the highest standards of financial accountability, transparency and reporting in support of the Corporation's focused mandate to reduce poverty through economic growth.

In 2012, MCC completed its eighth year of operations. Just as our operations grow and the tools to support them are improved and expanded, MCC continues to grow and improve our financial management capabilities to support those expanding operations.

Accountability and transparency are at the very core of MCC—they are what we ask of our country partners and attributes that we demand of ourselves. To achieve those goals, MCC updated its financial accounting system in the past year and revised critical processes for tracking and recording the grant activity we make through our country compacts. I am extremely proud of the financial improvements we have made and of the support delivered by our financial management professionals as we continue to ensure financial accountability and transparency in the Corporation's financial reporting.

I am also proud to report that MCC, for the second year in a row, received an unqualified or "clean" opinion on its financial statements. Clearly, we have continued to build on our prior year results with improvements and enhancements to our financial management processes and activities. MCC maintains a robust system of controls overseen by senior leadership.

While our financial statements are in good condition, MCC's financial processes and practices still have room for improvement. Our independent auditors identified one material weakness and three significant deficiencies in MCC's internal controls. The material weakness is related to the effectiveness of internal controls over financial reporting. We will take aggressive action in FY 2013 to address the underlying causes of this weakness. We will address the significant deficiencies, related to grant estimates, monitoring funds and information systems controls, just as aggressively.

I appreciate the continued support of the entire Corporation, with special thanks to the Office of Inspector General, as we continue to work together in our quest for excellence in financial management.

Chantale Yokmin Wong
Vice President, Department of Administration and Finance
Chief Financial Officer

Financial Section

The Principal Financial Statements have been prepared to report the financial position and the results of operations of the Millennium Challenge Corporation (MCC). The Statements have been prepared from the books and records of the Agency in accordance with formats prescribed by the Office of Management and Budget (OMB) in OMB Circular A-136, *Financial Reporting Requirements* (revised 8/3/2012). The statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity. The Agency has no authority to pay liabilities not covered by budgetary resources. Liquidation of such liabilities requires enactment of an appropriation. Comparative data for FY 2011 have been included. MCC is presenting the following financial statements and additional information:

- Balance Sheets
- Statements of Net Costs
- Statements of Changes in Net Position
- Statements of Budgetary Resources
- Notes to Financial Statements
- Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2012 and 2011

Note that totals may vary slightly due to rounding.

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Balance Sheets

As of September 30, 2012 and 2011 (in thousands)		
Intra-Governmental		
Fund Balance with Treasury *(Note 2)*	$ 5,321,289	$ 5,875,161
Advances — Federal *(Note 5)*	1,708	5,861
Total Intra-Governmental	**$ 5,322,997**	**$ 5,881,022**
Accounts Receivable *(Note 3)*	7,489	65
General Property, Plant, and Equipment *(Note 4)*	3,368	4,613
Advances — Public *(Note 5)*	154,253	192,187
Total Assets	$ 5,488,107	$ 6,077,887
Intra-Governmental		
Accounts Payable — Federal *(Note 1F)*	$ 215	$ 10,290
Contributions and Payroll Taxes Payable	716	528
Total Intra-Governmental	**$ 931**	**$ 10,818**
Accounts Payable — Non Federal *(Note 1F)*	16,757	14,979
Federal Employee and Veteran Benefits Payable	14	13
Accrual — Grant Liabilities *(Note 11)*	106,410	275,387
Accrued Funded Liabilities	6,293	8,531
Total Liabilities	$ 130,405	$ 309,728
Unexpended Appropriations — Other Funds	$ 5,346,633	$ 5,763,269
Cumulative Results of Operations — Other Funds	11,069	4,890
Total Net Position	$ 5,357,702	$ 5,768,159
Total Liabilities and Net Position	**$ 5,488,107**	**$ 6,077,887**

The accompanying notes are an integral part of these statements.

Statements of Net Cost

For the Years Ended September 30, 2012 and 2011 (in thousands)		
Compact Program Costs	$ 1,129,720	$ 1,449,285
609 (g) Program Costs	21,734	28,825
614 (g) Program Costs	220	51
Threshold Program Costs	16,371	49,002
Due Diligence Program Costs	41,478	37,629
Audit Costs	5,165	4,087
Administrative Costs	96,306	91,811
Net Costs of Operations	**$ 1,310,994**	**$ 1,660,690**

The accompanying notes are an integral part of these statements.

Statements of Changes in Net Position

For the Years Ended September 30, 2012 and 2011 (in thousands)		
Beginning Balances	$ 4,890	$ 6,119
Appropriations Used	1,314,837	1,657,002
Donations and Forfeitures of Property *(Note 1P)*	275	236
Imputed Financing	2,061	2,223
Total Financing Sources	1,317,173	1,659,461
Net Cost of Operations	(1,310,994)	(1,660,690)
Net Change	6,179	(1,229)
Cumulative Results of Operations	**$ 11,069**	**$ 4,890**
Beginning Balance	$ 5,763,269	$ 6,522,071
Appropriations Received	$ 898,200	$ 900,000
Other adjustments	—	(1,800)
Appropriations Received, net of adjustments	**$ 898,200**	**$ 898,200**
Appropriations Used	$ (1,314,837)	$(1,657,002)
Total Budgetary Financing Sources	(416,637)	(758,802)
Total Unexpended Appropriations	5,346,633	5,763,269
Net Position	**$ 5,357,702**	**$ 5,768,159**

The accompanying notes are an integral part of these statements.

Statements of Budgetary Resources

For the Years Ended September 30, 2012 and 2011 (in thousands)		
Unobligated balance brought forward, October 1	$ 1,264,708	$ 944,204
Recoveries of prior year unpaid obligations	11,068	4,152
Appropriations *(Note 1C)*	898,200	898,200
Total Budgetary Resources	**$ 2,173,976**	**$ 1,846,556**
Obligations incurred	$ 413,288	$ 581,848
Unobligated balance, end of year:		
Apportioned *(Note 9)*		
• Available	1,042,659	671,745
• Unavailable	718,029	592,963
Total unobligated balances, end of year	1,760,688	1,264,708
Total Status of Budgetary Resources	**$ 2,173,976**	**$ 1,846,556**
Unpaid obligations, brought forward, October 1	$ 4,609,454	$ 5,609,508
Obligations Incurred	413,289	581,848
Outlays (gross) (–)	(1,451,890)	(1,577,750)
Recoveries of prior year unpaid obligations (–)	(11,068)	(4,152)
Obligated Balance, end of year	**$ 3,559,785**	**$ 4,609,454**
Budget authority, gross	898,200	898,200
Outlays, gross	$ 1,451,890	$ 1,577,750

The accompanying notes are an integral part of these statements.

Notes to Financial Statements (As of September 30, 2012)

Note 1—Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements have been prepared to report the financial position, results of operations and budgetary resources for MCC as required by OMB Circular No. A-136, *Financial Reporting Requirements* (revised 8/3/2012), for form and content and in compliance with the Government Corporation Control Act (31 U.S.C. §9106). These financial statements have been prepared from MCC's books and records and are presented in accordance with the applicable requirements of OMB, and the Secretary of the Treasury.

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

- Balance Sheets;
- Statements of Net Costs;
- Statements of Changes in Net Position; and
- Statements of Budgetary Resources

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

The presentation used for the Statement of Budgetary Resources (SBR) prior to FY 2012 has been revised to reflect a new format required pursuant to the OMB Circular No. A-136, *Financial Reporting Requirements,* updated to better align with the Department of the Treasury Standard Form (SF) 133. Circular No. A-136 requires agencies to present both the FY 2012 and 2011 SBR in the same format. Accordingly, even though beginning balances for the FY 2011 SBR were not changed, certain reclassifications were made to the previously issued FY 2011 SBR to conform to the new format.

B. Reporting Entity

MCC was formed in January 2004 pursuant to the Millennium Challenge Act of 2003, as amended, (Public Law 108-199). MCC's mission is to reduce poverty by supporting sustainable, transformative economic growth in developing countries that create and maintain sound policy environments. Assistance is intended to

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provide economic growth and alleviate extreme poverty, strengthen good governance, encourage economic freedom, and promote investments in people.

C. Budgets and Budgetary Accounting

MCC's programs and activities are funded through no-year appropriations. Such funds are available for obligation without fiscal year limitation and remain available until expended. OMB apportions MCC program and administrative funds on an annual basis pursuant to statutory limitations in the annual appropriations bill. OMB segregates the apportionment of funds for administrative and audit oversight, compact programs, due diligence programs, 609(g) programs, 614(g) programs and threshold programs. MCC does not have any earmarked funds. Because of the no-year status of MCC appropriations, unobligated administrative, audit, and due diligence funds are not returned to the Treasury; however, unobligated balances as of September 30 for these three categories of funds are transferred to the program fund category for future obligation until expended.

D. Basis of Accounting

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

E. Fund Balance with Treasury

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

F. Accounts Payable

MCC records as liabilities all amounts due to others as a direct result of transactions or events that have occurred. Accounts payable represent amounts due to Federal and non-Federal entities for goods and services received by MCC, but not paid at the end of the accounting period. Accounts Payable—Federal represents payable transactions with other Federal government agencies (USAID, Department of the Interior, etc.), Accounts Payable—Non Federal represents transactions with non-federal entities.

G. Actuarial FECA Liability

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

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

H. Accrued Annual Leave

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

I. Net Position

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

J. Financing Sources

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

K. Retirement Benefits

MCC's employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). FERS was established by Public

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

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

L. Use of Estimates

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

Federal Accounting Standards Advisory Board Technical Release 12 (TR12), Accrual Estimates for Grant Programs, provides procedures for estimating accruals for grant programs. MCC has followed these procedures in developing its grant accrual methodology to calculate and record the accrual for the MCC Compact Grant Programs.

M. Contingencies

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

N. Judgment Fund

Certain legal matters to which MCC can be named as a party may be administered and, in some instances, litigated and paid by other Federal agencies. In general, amounts paid in excess of $2.5 thousand for Federal Tort Claims Act settlements or awards pertaining to these litigations are funded from a special appropriation administered by the Department of the Treasury, called the Judgment Fund.

Although the ultimate disposition of any potential Judgment Fund proceedings cannot be determined, management expects that any liability or expense that might ensue would not be material to MCC's financial statements.

O. Custodial Liabilities

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

P. Donated Services

MCC may on occasion utilize donated services from other Federal agencies, individuals and private firms in the course of business operations. The approximate fair market value of donated services for FY 2012 was $275 thousand and FY 2011 was $236 thousand.

Q. Transfers with Other Federal Agencies

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

MCC allocates funds, as the parent, to USAID. In FY 2012 and FY 2011, USAID transferred back to MCC budgetary authority of $10,499 thousand and $3,904 thousand, respectively. USAID receives these allocations as transfers-in and reports quarterly to MCC as the child. MCC also transfers an administrative fee to USAID for the purposes of administering the threshold programs. There were no transfers to USAID in FY 2012 and FY 2011.

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R. Fund Categories

MCC allocates costs among these major program categories:

- Compact funds comprise large, five-year grants for countries that pass MCC's eligibility criteria.
- 609 (g) funds cover contracts or grants that facilitate the development of a compact between MCC and a partner country.
- 614 (g) funds comprise research contracts for the purpose of improving data related to eligibility criteria.
- Threshold programs are smaller grants awarded to countries that come close to meeting the eligibility criteria for compacts.
- Due Diligence funds support the cost of assessing compact proposals and providing compact implementation oversight.
- Audit funds cover audits of MCC operations and programs; the USAID Office of Inspector General (OIG) performs the audit work.
- Administrative funds cover MCC operating expenses.

S. Advances

MCC has two major types of Advances associated with its compact agreements:

1. **Advances to Contractors made on behalf of the MCA** — MCC receives a periodic reporting of advances from MCAs to their contractors. MCC records corresponding entries to adjust advance and expense balances.
2. **Advances to MCAs** — MCC receives a periodic reporting of actual operating advances via the compact quarterly reporting process. Based on these reports, MCC adjusts advance and expense balances.

Note 2—Fund Balance with Treasury

The U.S. Treasury accounts for all U.S. Government cash on an overall consolidated basis. MCC is appropriated "general" funds only and maintains these balances in the Fund Balance with Treasury. The general fund line items on the Balance Sheet for FY 2012 and FY 2011 consisted of the amounts presented in Exhibit 1. The balance shown agrees with the balance shown in the Government-Wide Accounting System. The status of the general fund balances is summarized by obligated, unobligated and Non-Budgetary fund balances in Exhibit 2.

Exhibit 1: Fund Balance with Treasury as of September 30 (in thousands)

General Funds	$ 5,321,289	$ 5,875,161
Total	$ 5,321,289	$ 5,875,161

Exhibit 2: Status of Fund Balance with Treasury as of September 30 (in thousands)

Unobligated Balance		
Apportioned		
• Available	$ 1,042,659	$ 671,745
• Unavailable	718,029	592,963
Subtotal	$ 1,760,688	$ 1,264,708
Obligated Balance	3,559,785	4,609,454
Non-Budgetary FBWT	157	999
Reconciling Items	659	
Total	$ 5,321,289	$ 5,875,161

Note 3—Accounts Receivable, Net

Accounts Receivable reflects overpayments of payroll, travel and other MCC current and former employee expenses. It also reflects substantiated disallowed MCA expenditures. Total receivables at the end of FY 2012 and FY 2011 were $7,489 thousand and $65 thousand, respectively. Of the $7,489 thousand FY 2012 receivables, $6,900 thousand is the result of an amount due from Ghana for the recapture of the Agriculture Credit Program. Receivables that exist with foreign countries are considered sovereign debt. MCC uses individual account analyses to determine when accounts are uncollectible and therefore does not record an allowance for doubtful accounts based on the total account balance.

Note 4—General Property, Plant and Equipment, Net

MCC's property, plant and equiment (PP&E) costs are the associated leasehold improvements made to its leased office space as well as general equipment costs. The book value of all general PP&E for Fiscal Year 2012 and Fiscal Year 2011 was $3,368 thousand and $4,613 thousand, respectively. The status of the general fund balances for General PP&E is summarized for FY 2012 and FY 2011 in Exhibit 3 and Exhibit 4, respectively, below.

Exhibit 3: Status of General PP&E as of September 30, 2012 (in thousands)

General PP&E					
Leasehold Improvements	Straight-line	8–10 years	$ 10,924	$ 7,619	$ 3,305
Other General PP&E	Straight-line	5 years	139	76	63
Total			$ 11,063	$ 7,695	$ 3,368

Exhibit 4: Status of General PP&E as of September 30, 2011 (in thousands)

General PP&E					
Leasehold Improvements	Straight-line	8–10 years	$ 10,924	$ 6,402	$ 4,522
Other General PP&E	Straight-line	5 years	139	48	91
Total			$ 11,063	$ 6,450	$ 4,613

Note 5—Advances

Advances reflect amounts provided to compact countries and other Federal agencies in accordance with formal compacts or inter-agency agreements. As of September 30, 2012, MCC reported intragovernmental advances totaling $1,708 thousand and nongovernmental advances totaling $154,253 thousand. As of September 30, 2011, the amounts reported were $5,861 thousand and $192,187 thousand, respectively. The $37,934 thousand net decrease in nongovernmental advances is comprised primarily of the net effect of four compact closures, the addition of three new compacts and fluctuations in Advance balances in ongoing compacts.

Note 6—Leases

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

MCC also has short term leases for one corporate vehicle (through September 28, 2015) and for 18 copier machines (through September 29, 2017) utilized in both buildings. The future lease payments due are depicted in Exhibit 5 below.

Exhibit 5: Operating Leases (in thousands)			
FY 2013	$ 5,726	$ 1,942	$ 7,668
FY 2014	5,783	1,995	7,778
FY 2015	5,841	1,995	7,836
Total Future Lease Payments—Buildings	**$ 17,350**	**$ 5,932**	**$ 23,282**
FY 2013	$ 11	$ 45	$ 56
FY 2014	11	45	56
FY 2015	11	45	56
FY 2016		45	45
FY 2017		45	45
Total Future Lease Payments—Equipment	**$ 33**	**$ 225**	**$ 258**

Note 7—Intragovernmental Costs

The Statement of Net Cost reports the MCC's gross cost less earned revenues to arrive at net cost of operations. MCC has no earned revenue. Costs have been illustrated by MCC funded programs. Threshold program costs have dropped because MCC has signed no new threshold agreements since FY 2010 and there was no new threshold funding in FY 2011.

Exhibit 6 shows the value of exchange transactions between MCC and other Federal entities, as well as non-Federal entities. Intragovernmental costs relate to transactions between the MCC and other Federal entities. Nongovernmental costs relate to transactions between the MCC and non-Federal entities. MCC does not have any exchange revenues. The Intragovernmental and Nongovernmental Costs for FY 2012 and FY 2011 are depicted in Exhibit 6.

Exhibit 6: Intra-governmental Costs (in thousands)			
Compact	$ 6,531	$ 1,123,189	$ 1,129,720
609(g) Programs	6,554	15,180	21,734
614(g) Programs	—	220	220
Threshold Programs	1,491	14,880	16,371
Due Diligence	5,210	36,268	41,478
Audit	3,313	1,852	5,165
Administrative	18,980	77,326	96,306
Total—Program	**$ 42,079**	**$ 1,268,915**	**$ 1,310,994**

Exhibit 6: Intra-governmental Costs (in thousands)			
Compact	$ 4,518	$ 1,444,767	$ 1,449,285
609(g) Programs	3,531	25,294	28,825
614(g) Programs	—	51	51
Threshold Programs	12,681	36,321	49,002
Due Diligence	5,153	32,476	37,629
Audit	3,871	216	4,087
Administrative	25,135	66,676	91,811
Total—Program	**$ 54,889**	**$ 1,605,801**	**$ 1,660,690**

Note 8—Undelivered Orders at the End of the Period

Exhibit 7 presents Undelivered Orders, paid and unpaid, as of September 30, 2012 and 2011.

Exhibit 7: Undelivered Orders (in thousands)		
Administrative	$ 44,953	$ 35,654
Audit	711	840
609(g)	24,358	34,748
614(g)	4	224
Due Diligence	81,432	70,955
Compacts	3,399,289	4,297,756
Threshold	31,423	58,595
Total	**$ 3,582,170**	**$ 4,498,772**

Note 9—Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

MCC ensures that the information reported in its books is reflected within the Budget of the U.S. Government. Since MCC's financial statements are published before the President's Budget, this reconciliation is based on the Statement of Budgetary Resources column for FY 2011 and the FY 2011 actual data reported in the FY 2013 budget submission. FY 2012 actual data will be published within the 2014 Budget of the United States to be published in February 2013. Exhibit 8 reconciles the Budgetary Authority for the Combined Statement of Budgetary Resources and the Budget of the U.S. Government based on the actuals published for FY 2011. The MCC Budget Appendix can be found on the OMB website (http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/33_1.pdf). Go to International Assistance Programs. The budget for FY 2014 will be published in February, 2013. When published, it will be available on http://www.whitehouse.gov/omb.

Exhibit 8: Reconciliation of Budgetary Authority for the Combined Statement of Budgetary Resources and the Budget of the U.S. Government (in thousands)

Combined Statement of Budgetary Resources	$ 898,200
Deductions for Offsetting Receipts	(1,000)
Budget of the U.S. Government	897,200

The $1,000 thousand difference is due to a USAID adjustment that was not made prior to the cutoff for submitting changes to the Budget of the U.S. Government. The adjustment related to an incorrect recording of $1,000 thousand as offsetting receipts in the Budget.

MCC has disaggregated its Apportionment line on the Statement of Budgetary Resources. Instead of one amount, the Apportionment line is shown with two supporting lines—available and not available. MCC believes presentation of the apportionment as one line does not reflect the actual availability of funds. MCC's implementing legislation requires that Congressional Notification be made before apportioned funds can be made available for Compacts. MCC Apportionments are reported on two lines: available and unavailable. Unavailable balances represent amounts for which Congressional notification has not been made. The FY 2011 amounts have been adjusted to reflect the FY 2012 format changes to the Statement of Budgetary Resources.

Note 10—Reconciliation of Net Cost of Operations to Budget

Exhibit 9 and Exhibit 10 reconcile the resources available to MCC to finance operations with the net cost of operating MCC's programs. Some operating costs, such as depreciation, do not require direct financing sources. The exhibits illustrate the reconciliation of Net Cost of Operations to Budget for FY 2012 and FY 2011, respectively.

Exhibit 9: Reconciliation of Net Cost of Operations to Budget as of September 30, 2012 (in thousands)

Budgetary Resources Obligated			
Obligations Incurred	$ 413,289		
Recoveries of prior year unpaid obligations	(11,068)	**Gross Costs**	$ 1,310,994
Other financing sources	2,336		
Total resources used to finance activities	**$ 404,557**		
Total resources used to finance items not part of the net cost of operations	$ 909,179		
Total components of net cost of operations that will not require or generate resources	1,244	**Less: Earned Revenue**	–
Advance liquidation adjustment	(3,986)		
Net Cost of Operations	**$ 1,310,994**	**Net Cost of Operations**	**$ 1,310,994**

Exhibit 10: Reconciliation of Net Cost of Operations to Budget as of September 30, 2011 (in thousands)

Budgetary Resources Obligated			
Obligations Incurred	$ 581,848		
Recoveries of prior year unpaid obligations	(4,152)	**Gross Costs**	$ 1,660,690
Other financing sources	2,460		
Total resources used to finance activities	**$ 580,156**		
Total resources used to finance items not part of the net cost of operations	$ 1,079,290	**Less: Earned Revenue**	–
Total components of net cost of operations that will not require or generate resources	1,244		
Net Cost of Operations	**$ 1,660,690**	**Net Cost of Operations**	**$ 1,660,690**

Note 11—Accrual – Grant Liabilities

The $168,977 thousand decrease in grant liabilities was the result of:

- Decreases related to completed Compacts ($135,862 thousand). There were six compact that had accruals in FY 2011 that did not have accruals in FY 2012.
- Decreases related to change in estimating methodology ($55,264 thousand).
- Increases related to Compact start-ups, $22,149 thousand. There were eight compacts that had accruals in FY 2012 that did not have accruals in FY 2011.

In FY 2012 MCC modified its grant liability estimation methodology. MCC approves MCA spending authority quarterly based on MCC approved financial plans developed by each MCA. MCC discounts unused spending authority by a rolling average of actual disbursements to calculate the estimated liability. The difference in the grant liability between FY 2012 and FY 2011 was due to this change in the estimation methodology.

Independent Auditor's Report

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, 2012 AND 2011

AUDIT REPORT NO. M-000-13-001-C
November 15, 2012

WASHINGTON, DC

Financial information contained in this report may be privileged. The restrictions of 18 USC 1905 should be considered before any information is released to the public.

Office of Audit
for the Millennium Challenge Corporation

November 15, 2012

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

Subject: Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2012 and 2011 (Report No. M-000-13-001-C)

Dear Mr. Yohannes:

Enclosed is CliftonLarsonAllen LLP's, final report on the subject audit. The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of CliftonLarsonAllen LLP, to audit the financial statements of the Millennium Challenge Corporation (MCC) for the period ending September 30, 2012. The contract required that the audit be performed in accordance with United States Generally Accepted Government Auditing Standards, Office of Management and Budget (OMB) Bulletin 07-04 as amended, Audit Requirements for Federal Financial Statements, and the GAO/PCIE Financial Audit Manual.

The Independent Auditors expressed an unqualified opinion on MCC's FY 2012 Financial Statements. The report stated that the financial statements referred to above present fairly, in all material respects, the net position of MCC as of September 30, 2012, and its net cost, changes in net position and budgetary resources for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America. MCC's financial statements as of September 30, 2011 were audited by other auditors.

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Ave, NW
Washington, DC 20523
www.usaid.gov/oig

In its audit of MCC's fiscal year 2012 financial statements the auditor's identified one issue that was considered a material weakness and three other issues that were considered significant deficiencies. These matters are listed below and are detailed in the auditor's report.

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

Material Weakness

- Ineffective and Inefficient Interrelationship among Software, Personnel, Procedures, Controls and Data within MCC's Financial Management Systems

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

Significant Deficiencies

- Validation Control over Grant Accrual Estimates Needs to be Strengthened
- Monitoring Control over Funds Provided to MCAs Needs Improvement
- Information Systems Controls Need Improvement

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

In carrying out its oversight responsibilities, the OIG reviewed CliftonLarsonAllen LLP, Internal Audit Report and 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; or on MCC's compliance with other laws and regulations. CliftonLarsonAllen LLP is responsible for the attached auditor's report, dated November 15, 2012, and the conclusions expressed in the report. However, our review disclosed no instances where CliftonLarsonAllen LLP, did not comply, in all material respects, with applicable standards.

To address the material weakness and significance deficiencies in internal controls reported by CliftonLarsonAllen LLP, we are listing below the findings with 22 recommendations to MCC's management:

Material Weakness

Ineffective and Inefficient Interrelationship among Software, Personnel, Procedures, Controls and Data within MCC's Financial Management Systems

Millennium Challenge Corporation

Recommendations: With regards to the core financial system, we recommend that MCC:

1. Perform a comprehensive review and determine whether the service provider's financial management system is substantially in compliance with the federal financial management system's requirements and meeting MCC financial management and reporting needs. As part of this review, management should determine if a separate grants management system that focuses on program administrations that interfaces with the core financial system is needed.
2. Investigate and correct the causes for the underlying system errors and limitations that prevent or delay the recording, processing, and summarizing of accounting transactions.
3. Review USSGL transaction posting models so that all routine accounting transactions are included in the normal accounting processes. Manual adjusting journal entries should be used for limited transactions like unusual one-time entries. All valid recurring entries that are currently entered manually should have standard transaction codes set-up to prevent posting errors.

With regards to the workbook, we recommend that MCC:

4. Hard code key cells in the excel spreadsheets used in preparing and generating the financial statements to prevent unintentional or inadvertent changes.
5. Limit access and ability to make changes to the workbook to a few personnel. Assign a staff and a designate as primarily responsible and accountable for the workbook.
6. Create a log to document changes to the workbook, the date of change, the person making the change, and the changes made.
7. Investigate the use of alternative approaches such as the use of a financial statement generation software tool or other financial management system that can interface with the trial balance or the core financial system and automatically generate the financial statements.

With regards to supervisory reviews, we recommend that MCC:

8. Develop a comprehensive financial statements review process that details specific steps performed, results of such reviews, steps taken to resolve discrepancies noted, and related management resolution.
9. Implement an effective management review using the comprehensive review process developed in recommendation 8 to ensure that all transactions for the accounting period are accurately and completely reflected in the financial statements, current year beginning balances agreed to prior year audited balances, and reconciling items are recorded timely. Such management reviews should be performed quarterly and at year-end timely with evidence of management sign-off signifying levels of reviews performed.

With regards to financial staff resource management, we recommend that MCC:

10. Cross-train MCC financial staff on the financial statements preparation process to ensure that there is more than one person knowledgeable and can prepare the financial statements.

Significant Deficiencies

Validation Control over Grant Accrual Estimates Needs to be Strengthened

Recommendations: We recommend that MCC:

11. Perform a grant accrual look back analysis on a quarterly basis. The look back analysis and the results should provide MCC sufficient information to explain unusual variances between actual and estimates, or support updating the current grant accrual methodology. Such periodic assessment of the adequacy of the grant accrual methodology should be documented and supported by data analysis. The accrued liability amount is subject to the risks that actual subsequent disbursement amount may be significantly different from management's estimate. When this occurs, management should further analyze the drivers/factors to ensure the validity and reasonableness of the estimation methodology.
12. Update the Expense Accruals Policy and Procedures to reflect the change in the methodology.
13. Develop audit procedures for the MCA audit to compare spending authority request amount against actual expenses, and investigate and document significant variances. The results should be provided to MCC, which can use this information collected from the MCA audits as data store to validate or enhance the current methodology.
14. Continue to enhance the accrual methodology.

Monitoring Control over Funds Provided to MCAs Needs Improvement

A. Audit Reports

Recommendations:

15. MCC management should have control over how these audits should be conducted to meet its financial and programmatic accountability, needs and requirements. MCC management should collaborate with USAID OIG to clarify and document management roles, responsibilities, and performance standards and the USAID OIG oversight role with regards to MCA audits.
16. MCC needs to evaluate its resources, capability, and ability to monitor and review the quality and performance of the audits and the audit firms to track and conduct follow-up of corrective action plans with the MCAs in a timely manner.

B. Final Quarterly Financial Report (QFR)

Recommendations:

We recommend that MCC:

17. Utilize the QFRs and the monthly reconciliations as monitoring tools over the MCA's financial reporting process and the MCC's validation of its financial records. To be effective as monitoring tools, the re-designing of the QFR form and the development and documentation of the monthly reconciliation process should ensure that relevant data and information are reported by the MCAs and reported timely.
18. Ensure that MCA reconciliations are provided to MCC and reviewed to investigate material variances and make corrections, if any.
19. Require the MCA audit firms to test the design and effectiveness of the MCA's internal control over the QFRs and the monthly reconciliation, and to test for the accuracy of the balances and reconciliation.
20. Develop and implement reconciliation procedures to document the complete reconciliation between the MCA's final QFR and MCC's records.

C. Expired Compacts Not Financially Closed-Out

Recommendations:

We recommend that MCC:

21. Timely assess the MCA's need for the remaining compact funds so that the funds could be de-obligated within the timeline in the policy and procedures after the compact expires.
22. Develop and implement a financial management policy that separates the programmatic close-out process from the financial close-out process. This policy should clearly layout the expected timing for de-obligation.

Information Systems Controls Need Improvement

Recommendation:

We are not repeating the recommendations which are included in the USAID OIG Report titled "Audit of Millennium Challenge Corporation's Fiscal Year 2012 Compliance with Federal Information Security Management Act of 2002," Audit Report M-000-13-001-P, dated November 6, 2012.

In finalizing the report, CliftonLarsonAllen LLP, evaluated MCC's response to the report and acknowledged that management decisions have been reached on all of the recommendations.

MCC plans to complete its corrective actions by June 30, 2013, or have documented the appropriate timeline in which actions will be completed.

The OIG acknowledges MCC's management decisions for all 22 recommendations. Please inform us when final action has been achieved.

We appreciate the cooperation and courtesies extended to our staff and to the staff of CliftonLarsonAllen LLP, during the audit. Please contact Fred Jones at (202) 216-6963, if you have any questions concerning this report.

Sincerely,

Richard J. Taylor
Deputy Assistant Inspector General
for Audit
Millennium Challenge Corporation

cc: Steven Kaufmann, Chief of Staff
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MILLENNIUM CHALLENGE CORPORATION (MCC)

September 30, 2012

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CliftonLarsonAllen

CliftonLarsonAllen LLP
www.cliftonlarsonallen.com

INDEPENDENT AUDITOR'S REPORT

To the Inspector General
U.S. Agency for International Development

To the Board of Directors
Millennium Challenge Corporation

We have audited the accompanying balance sheet of the Millennium Challenge Corporation (MCC) as of September 30, 2012, and the related statements of net cost and changes in net position, and the combined statement of budgetary resources ("financial statements") for the year then ended. The objective of our audit was to express an opinion on the fairness of these financial statements. In connection with our audit, we also considered the internal control over financial reporting and considered MCC's compliance with laws and regulations. In our audit, we found:

- The financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America (U.S.);
- One material weakness and three significant deficiencies in internal control over financial reporting and compliance with laws and regulations;
- No instance of reportable noncompliance with selected provisions of laws and regulations tested.

The following sections and exhibits discuss in more detail: (1) above conclusions, (2) Management's Discussion and Analysis (MD&A) and other accompanying information, (3) management's responsibility for the financial statements, (4) our responsibility for the audit, (5) management's response and our evaluation of their response, and (6) the current status of prior year's findings and recommendations.

Opinion on the Financial Statements

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of MCC as of September 30, 2012 (FY 2012), and its net cost; changes in net position; and budgetary resources for the year then ended in conformity with accounting principles generally accepted in the United States. The financial statements of MCC as of and for the year ended September 30, 2011 (FY 2011) were audited by other auditors, whose report dated November 10, 2011, expressed an unqualified opinion on those financial statements. MCC reclassified certain financial statement line items of the combined statement of budgetary resources (SBR) for FY 2011 to be consistent with FY 2012 presentation in accordance with accounting principles generally accepted in the United States. The other auditors reported on the financial statements before these reclassifications. We have audited the reclassifications in the SBR. In our opinion, such reclassifications are appropriate and have been properly applied.

1

Millennium Challenge Corporation

Report on Internal Control over Financial Reporting and Compliance

In planning and performing our audit, we considered MCC's internal control over financial reporting and compliance (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MCC's internal control or on management's assertion on internal control included in the MD&A. Accordingly, we do not express an opinion on the effectiveness of MCC's internal control or on management's assertion on internal control included in the MD&A.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the MCC's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a control deficiency, or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we identified a combination of deficiencies in internal control described in Exhibit 1 that we consider to be a material weakness and other deficiencies described in Exhibit 2 that we consider to be significant deficiencies.

Also, as required by Office of management and Budget (OMB) Bulletin 07-04, *Audit Requirements for Federal Financial Statements*, as amended, we compared the material weakness disclosed during the audit with those material weaknesses reported in the MCC's Federal Managers Financial Integrity Act (FMFIA) report that relate to the financial statements. Our audit did not identify any material weakness that were not identified by MCC in their FMFIA report.

We also noted non-reportable matters that we communicated to MCC and will include in a separate management letter to MCC to be dated November 12, 2012.

Report on Compliance and Other Matters

In connection with our audit, we performed tests of MCC's compliance with selected provisions of applicable laws and regulations. The results of our tests disclosed no instances of noncompliance that are required to be reported in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States or OMB Bulletin 07-04, as amended. However, the objective of our audit was not to provide an opinion on compliance with laws and regulations. Accordingly, we do not express such an opinion.

Status of Prior Year's Audit Findings and Recommendations

We have reviewed the status of MCC's corrective actions with respect to the findings and recommendations included in prior year's Independent Auditor's Report dated November 10, 2011. The status of prior year's findings and recommendations is presented in Exhibit 3.

2

Other Information

Accounting principles generally accepted in the U.S. require that MCC's MD&A be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the MD&A in accordance with auditing standards generally accepted in the U.S., which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other information included in the Annual Financial Report, other than the financial statements, MD&A, and the Independent Auditor's Report is presented for additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Management's Responsibility for the Financial Statements

MCC management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the U.S., (2) designing, implementing, and maintaining internal control to provide reasonable assurance that the broad control objectives of FMFIA are met, and (3) complying with other applicable laws and regulations.

Auditor's Responsibility

We are responsible for conducting our audit in accordance with auditing standards generally accepted in the U.S.; the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin 07-04, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the U.S. We are also responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements, and laws for which OMB Bulletin 07-04 requires testing, (3) performing limited procedures with respect to certain other information appearing in the published Annual Financial Report.

In order to fulfill these responsibilities, we (1) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; (2) assessed the appropriateness of the accounting policies used and the reasonableness of significant estimates made by management; (3) evaluated the overall presentation of the financial statements; (4) obtained an understanding of MCC and its operations, including its internal control related to financial reporting (including safeguarding of assets) and compliance with laws and regulations (including execution of transactions in accordance with budget authority); (5) evaluated the effectiveness of the design of internal control; (6) tested the operating effectiveness of relevant internal controls over financial reporting and compliance; (7) considered the design of the process for

Millennium Challenge Corporation

evaluating and reporting on internal control and financial management systems under FMFIA; (8) tested compliance with selected provisions of certain laws and regulations. The procedures selected depend on the auditor's judgment, including our assessment of risks of material misstatement of the financial statements, whether due to fraud or error. We believe we obtained sufficient and appropriate audit evidence on which to base our conclusions.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our audit results to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws and regulations applicable to MCC. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on MCC's financial statements and those required by OMB Bulletin 07-04 that we deemed applicable to MCC's financial statements for the fiscal year ended September 30, 2012. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

MCC's Comments and our Evaluation

Management concurred with all our findings and recommendations. Management's response to our report is presented in Exhibit 4.

****

This report is intended solely for the information and use of MCC management, U.S. Agency for International Development (USAID) Office of Inspector General, OMB, the Government Accountability Office (GAO), and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

CLIFTONLARSONALLEN LLP

CliftonLarsonAllen LLP

Arlington, Virginia
November 12, 2012

MILLENNIUM CHALLENGE CORPORATION
INDEPENDENT AUDITOR'S REPORT EXHIBIT 1
September 30, 2012

<u>MATERIAL WEAKNESS</u>

1. **Ineffective and Inefficient Interrelationship among Software, Personnel, Procedures, Controls and Data within MCC's Financial Management Systems**

GAO *Standards for Internal Control in the Federal Government* states that internal control is not one event, but a series of actions and activities that occur throughout an entity's operations and on an ongoing basis. Control activity, which is one of the standards for internal control, may be applied in a computerized information system environment, or through manual processes. Information system control should be installed at an application's interfaces with other systems to ensure that all inputs are received and are valid, and outputs are correct and properly distributed. Some control activities include: controls over information processing, management of human capital, proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions. Monitoring, which is another standard for internal control, is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties.

Accounting is a systematic process of identifying, recording, measuring, classifying, verifying, summarizing, interpreting and communicating financial events. These financial events are ultimately presented in financial statements through the financial reporting process. Each step in the accounting process is an integral part of the financial reporting process.

A financial management system includes the core financial system and the financial portions of mixed systems necessary to support financial management, including automated and manual processes, procedures and controls, data, software, and support personnel dedicated to the operation and maintenance of system functions.

MCC has made significant progress this year by developing and implementing a grant accrual methodology which will be the foundation for future enhancements. MCC has also reduced some manual processes in its financial statements preparation where financial data and new accounts are no longer manually entered and financial data are now automatically populating all statements, including new accounts. However, MCC needs to continue to strengthen its financial reporting processes and controls. The interrelationship among software, personnel, procedures, controls and data within MCC's financial management systems (both manual and automated) is ineffective and inefficient as described below:

a. MCC uses a shared services provider (SSP) to process its accounting transactions. The SSP's core financial system current configurations prevent MCC from recording significant transactions in a systematic manner. Our review of the September 30, 2012 SSP's open system ticket report, which tracks financial system issues, identified issues that remain unresolved for an unreasonable period of time. Due to the volume and variety of transactional financial events that MCC must record relating to its grantees; MCC frequently has to prepare manual adjustments at the back end of the transactions to correct errors such as the differences between the a) Purchase Order (PO) and General Ledger (GL) module, b) Accounts Payable (AP) and GL module, c) incorrect postings, d) system interface errors, and e) others. This system deficiency, combined with inadequate and untimely corrective actions, negatively impact MCC's ability to record transactions timely, properly, and accurately. Although MCC applied

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compensating controls to detect and correct these errors, with the sheer volume and complexity of these transactions (automated and manual), there is a high risk that errors will not be detected and corrected timely or not detected at all. Our audit identified instances where this situation occurred. Moreover, this system deficiency negatively impacts MCC's limited staff resources.

OMB Circular A-127, *Financial Management Systems*, which is the government-wide policies and standards issued pursuant to FMFIA, states that agencies are responsible for managing their financial management system even when they utilize a service provider to implement, operate and maintain the systems. Agencies must ensure that their financial management systems meet applicable Federal requirements and are adequately supported throughout the systems' life cycle. Furthermore, agencies must monitor the service provider's performance and ensure that service failures are resolved promptly.

b. Although MCC has made strides in improving its financial reporting process by implementing certain quality control review processes in response to prior year's findings, much still need to be done. MCC's financial statements preparation process continues to be manually intensive and susceptible to errors even though certain functionalities have been automated. MCC uses a complex excel workbook (workbook) to generate its financial statements. Trial balances from the core financial system and USAID are cut and pasted into the workbook. Manual journal entries and on-top adjustments (OTAs) are also posted into the workbook. The workbook then automatically generates the financial statements from these data inputs. Due to system issues described in 1.a. above, the trial balance generated by the core financial system did not have the prior year final audited balances. Therefore, MCC has to post OTAs pertaining to prior year to correct beginning balances. In addition, MCC posts similar OTAs but for the current year to adjust or correct ending balances. These beginning and ending balances OTAs are posted into the workbook each time the financial statements are prepared (quarterly). Our audit identified instances where MCC missed posting beginning balances OTAs and manual journal entries into the workbook at June 30, 2012 and September 30, 2012.

c. The workbook utilized in the preparation of the financial statements did not have data edit lock and data change control. The workbook is accessible to many personnel including temporary financial personnel outside of key MCC financial staff, each having the ability to make changes to the workbook. In addition, due to the complexity of the spreadsheets in the workbook with various unprotected formulas and linkages, the risks of data manipulation and/or unintended data changes can introduce errors that would be difficult to detect and may be left undetected. Moreover, due to lack of documented supervisory review of the workbook, we could not verify that supervisory reviews were performed.

d. In reviewing the June 30, 2012 financial statements, we identified errors that led us to question the effectiveness of supervisory reviews, or the implementation of these reviews due to lack of documented evidence of reviews.

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e. Internal control is effected by people. It is not merely about policy manuals, systems, and forms, but about people at every level of an organization that impact internal control. Good human capital policies and practices are critical internal control environmental factors. We understand that MCC has limited staff and has to use temporary year-end financial staff who may not be familiar with the inner working of MCC operations. In addition, MCC relies heavily on contract staff in the preparation and generation of the financial statements. The contract staff holds immense institutional knowledge in the inner workings of MCC's business transactions and various "fixes or adjustments" required for financial reporting and financial statement preparation. MCC runs the risk of not being able to produce fairly presented financial statements timely without these key contract staff.

Recommendations

With regards to the core financial system, we recommend that MCC:

1. Perform a comprehensive review and determine whether the service provider's financial management system is substantially in compliance with the federal financial management system's requirements and meeting MCC financial management and reporting needs. As part of this review, management should determine if a separate grants management system that focuses on program administrations that interfaces with the core financial system is needed.

2. Investigate and correct the causes for the underlying system errors and limitations that prevent or delay the recording, processing, and summarizing of accounting transactions.

3. Review USSGL transaction posting models so that all routine accounting transactions are included in the normal accounting processes. Manual adjusting journal entries should be used for limited transactions like unusual one-time entries. All valid recurring entries that are currently entered manually should have standard transaction codes set-up to prevent posting errors.

With regards to the workbook, we recommend that MCC:

4. Hard code key cells in the excel spreadsheets used in preparing and generating the financial statements to prevent unintentional or inadvertent changes.

5. Limit access and ability to make changes to the workbook to a few personnel. Assign a staff and a designate as primarily responsible and accountable for the workbook.

6. Create a log to document changes to the workbook, the date of change, the person making the change, and the changes made.

7. Investigate the use of alternative approaches such as the use of a financial statement generation software tool or other financial management system that can interface with the trial balance or the core financial system and automatically generate the financial statements.

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With regards to supervisory reviews, we recommend that MCC:

8. Develop a comprehensive financial statements review process that detail specific review steps performed, results of such reviews, steps taken to resolve discrepancies noted, and related management resolution.

9. Implement an effective management review using the comprehensive review process developed in recommendation 8 to ensure that all transactions for the accounting period are accurately and completely reflected in the financial statements, current year beginning balances agreed to prior year audited balances, and reconciling items are recorded timely. Such management reviews should be performed quarterly and at year-end timely with evidence of management sign-off signifying levels of reviews performed.

With regards to financial staff resource management, we recommend that MCC:

10. Cross-train MCC financial staff on the financial statements preparation process to ensure that there is more than one person knowledgeable and can prepare the financial statements.

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SIGNIFICANT DEFICIENCIES

2. Validation Control over Grant Accrual Estimates Needs to be Strengthened

MCC reported approximately $1.1 billion in compact grant related expenditures and an accrued grant liability of $106 million for expenditures incurred by the Millennium Challenge Accounts (MCAs) but not yet paid by MCC at September 30, 2012. MCC applied its new grant accrual methodology for the first time at September 30, 2012. The first three quarters' financial statements accruals were based on data calls. MCC revised its methodology in an effort to improve and streamline the accrual process employed in prior year. MCC recognized that prior year grant accrual process, which involved data calls from the MCAs, was based on the best information available at the time. However, this manual process was cumbersome, time consuming, labor intensive, time sensitive, and inconsistent, thus contributing to a high risk for errors. To help MCC reassess this process, MCC hired an audit and consulting firm to provide a detailed analysis and make recommendations on the appropriate methodology for the grant accrual estimate.

MCC new accrual methodology is calculated based on an MCA's unused spending authority. MCC approves a quarterly spending authority in advance for each MCA. The unused spending authority at the end of the quarter is used in the accrual calculation for each MCA. MCC uses the MCA disbursement rate against the spending authority along with the disbursement rates for the last three quarters to determine an average rate. The average rate is then subtracted against 100 percent to arrive at a rate that is applied to the unused spending authority in calculating the grant accrual estimate for the MCA.

In reviewing the calculation of the accrual estimates and the supporting documentation, we noted many instances of calculation errors, use of incorrect spending authority, incorrect formulas, omitted calculations, and missing documentation. Also, there was no documentation of look back analysis and investigations of unusual fluctuations, if any, to validate the reasonableness of the accrual estimates. An accrual look back analysis involves reviewing past accrual estimates and analyzing whether the past estimates are reasonable when compared to the actual. We understand that this is a new methodology and MCC has not had an opportunity to update its Expense Accrual Policy and Procedures and perform a robust validation process.

FASAB Federal Financial Accounting Technical Release (TR) 12, *Accrual Estimates for Grant Programs*, states that "As part of agencies' internal control procedures to ensure that grant accrual estimates for the basic financial statements were reasonable, agencies should validate grant accrual estimates by comparing the estimates with subsequent grantee reporting."

Recommendations

We recommend that MCC:

11. Perform a grant accrual look back analysis on a quarterly basis for a sufficient period of time to develop a pattern or trend. The look back analysis and the results should provide MCC sufficient information to explain unusual variances between actual and estimates, or support updating the current grant accrual methodology. Such periodic assessment of the adequacy of the grant accrual methodology should be documented and supported by data analysis. Note that the accrued liability amount is subject to the risks that actual

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subsequent disbursement amount may be significantly different from management's estimate. When this occurs, management should further analyze the drivers/factors to ensure the validity and reasonableness of the estimation methodology.

12. Update the Expense Accruals Policy and Procedures to reflect the change in the methodology. At a minimum, the policy and procedures should include the following:
    a. documentation of the procedures and flow of information used in developing grant accrual estimates;
    b. a discussion of who (position title) is responsible for each step of the estimate as well as the review and approval process followed;
    c. the model used, the rationale for selecting the specific methodology, and, for programs with sufficient historical data, the degree of calibration within the projected spending model;
    d. the sources of information, the logic flow, and the mechanics of the model, including the formulas and other mathematical functions.

13. Develop audit procedures for the MCA audit to compare spending authority request amount against actual expenses, and investigate and document significant variances. The results should be provided to MCC, which can use this information collected from the MCA audits as data store to validate or enhance the current methodology.

14. Continue to enhance the accrual methodology by considering the following:
    a. stratifying the MCAs based on variances in their spending rates and/or stages in the compact's life cycle;
    b. addressing situations where the MCA exceeds its quarterly spending authority;
    c. addressing situations where the compact has expired and there is no spending authority and disbursements are still occurring;
    d. obtaining detailed document level breakdown of expenses to be used to compare against the accrual estimates;
    e. other factors as deemed necessary to achieve an acceptable precision of the accrual estimate.

3. Monitoring Control over Funds Provided to MCAs Needs Improvement

OMB Circular A-123, *Management Responsibility for Internal Control*, states that monitoring the effectiveness of internal control should occur in the normal course of business. In addition, periodic reviews, reconciliations or comparisons of data should be included as part of the regular assigned duties of personnel. Periodic assessments should be integrated as part of management's continuous monitoring of internal control, which should be ingrained in the agency's operations. If an effective continuous monitoring program is in place, it can level the resources needed to maintain effective internal controls throughout the year.

An adequate monitoring system oversees the design, implementation, and effectiveness of controls in mitigating risks. This monitoring system can be structured as an ongoing assessment program (for instance, supervisory reviews of day to day financial operations and reporting) or as a point in time program when a point in time assessment is required (for instance, MCA audits).

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When a country is awarded a grant (compact), it sets up its own local MCA accountable entity to manage and oversee all aspects of implementing the compact. The MCAs, as the grantees of MCC's funds, are responsible for submitting financial, programmatic and compliance documentation to MCC in accordance with their compact agreements with MCC and other administrative requirements. MCC, as the grantor, is responsible for reviewing and monitoring the MCA's compliance with the compact agreement and other administrative requirements. MCC needs to continue to strengthen its monitoring controls over the funds provided to the MCAs.

A. *Audit Reports*

MCAs are required to obtain an annual (or semi-annual as agreed upon) financial audit of the MCC funds by an independent auditor. We reviewed the audits covering the last two years for 13 MCAs, which accounted for a total of 25 MCA audit reports. Similar to last year's finding, 20 out of 25 (or 80 percent) audit reports were not received timely or were already due but not yet received as of July 20, 2012, our test date. There were 15 audit reports that were submitted late, ranging from 2 months to 9 months late, and 5 audit reports due but not yet received ranging from 1 month to 3 months late as of the test date.

A financial audit of the MCA Fund Accountability Statement conducted by an independent auditor in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States, provides an assurance to MCC that the MCA's revenues received, costs incurred, and commodities and technical assistance directly procured by the MCC are not materially misstated, and that tests of MCA's internal control and compliance with compact terms and applicable laws and regulations related to MCC funded programs were performed. The MCA financial audit is a key MCC internal control over monitoring of MCA's control over financial reporting and compliance and its reliance on MCA's financial reports. Accordingly, MCC should ensure that these audits are performed and submitted timely, reviewed timely, and corrective actions, if any, are implemented timely.

A timely audit involves the timely engagement of an audit firm by the MCA, an agreed upon timeline that ensures that the deliverables are provided within the deadlines, quality deliverables from the audit firms, and timely responses from the MCA and the audit firms. MCC has the monitoring responsibility over the audit process, and the USAID OIG has the oversight responsibility over the MCC's monitoring process. The USAID OIG provides oversight by reviewing both the initial and the close-out planning documents received from the MCAs. We understand that both USAID OIG and MCC are working together to minimize the delays in the MCA audits, but more can be done to address the root causes of these delays.

Recommendations

15. Monitoring the timeliness, completeness, effectiveness, and implementation of corrective action plans of the MCA audits is ultimately MCC management responsibility. MCC management should have control over how these audits should be conducted to meet its financial and programmatic accountability, needs and requirements. USAID OIG has the oversight responsibility to ensure that MCC management's monitoring of MCA audits are designed properly and operating effectively. We recommend therefore, that MCC management collaborate with USAID OIG to clarify and document management roles,

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responsibilities, and performance standards and the USAID OIG oversight roles with regards to these MCA audits.

16. MCC needs to evaluate its resources, capability, and ability to monitor and review the quality and performance of the audits and the audit firms to track and conduct follow-up of corrective action plans with the MCAs in a timely manner.

B. *Final Quarterly Financial Report (QFR)*

MCC requires the MCA to submit a Schedule C (CPS payments only) of the QFR (final QFR) 30 days prior to the program closure date to ensure that the MCA and the MCC books are reconciled prior to the submission of the final financial report. We reviewed two MCAs that closed in fiscal year 2012 by comparing the award amount, disbursement amount, and the remaining balance from the final QFR to what MCC reported. The final QFRs were received from the MCAs in February and May of 2012. Our review disclosed that the total disbursements and compact balance amounts reported by the MCAs in their final QFRs differed between $1 million and $3.5 million from the MCC reported amounts. In one of the MCAs we reviewed, MCC indicated that it has not prepared a reconciliation. In another MCA we tested, MCC provided a spreadsheet that included payment information from the core financial system. There was no clear documentation of a comparison made between the MCA and MCC records, differences noted, and the resolution of differences, if any. However, there were comments throughout the spreadsheet that seemed to indicate no support for some payments, some duplicate payments that have not been resolved, some incorrect payment amounts, and payments made to the wrong fund.

MCC requires the MCA to perform a monthly reconciliation of the CPS monthly Summary Report (of disbursements) from the MCC core financial system to the MCA's accounting records. Corrections are processed through the use of a Payment Inquiry Form (PIF) to address discrepancies and resolve them with the SSP. MCC receives copies of the PIF and a monthly certification letter from the MCA stating that reconciliation was performed and that the MCA records agree with the MCC records. The actual reconciliation is not provided to MCC or to the SSP.

MCC is not taking advantage of important tools in monitoring the MCAs' financial reporting process and validating its financial records. It has not established formal procedures for how the MCAs should document and report their monthly reconciliation of the compact award and expenses. Documented reconciliations will help to expedite the compact close out process. MCC also has not established formal procedures for how the reconciliation to the MCA final QFR is to be documented and the timeline for completion.

Recommendations

We recommend that MCC:

17. Utilize the QFRs and the monthly reconciliations as monitoring tools over the MCA's financial reporting process and the MCC's validation of its financial records. To be effective as monitoring tools, the re-designing of the QFR form and the development and documentation of the monthly reconciliation process should ensure that relevant data and information are reported by the MCAs and reported timely.

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18. Ensure that MCA reconciliations are provided to MCC and reviewed to investigate material variances and make corrections, if any.

19. Require the MCA audit firms to test the design and effectiveness of the MCA's internal control over the QFRs and the monthly reconciliation, and to test for the accuracy of the balances and reconciliation.

20. Develop and implement reconciliation procedures to document the complete reconciliation between the MCA's final QFR and MCC's records.

C. *Expired Compacts Not Financially Closed-Out*

As of June 30, 2012, there were six compacts that expired, but were not financially closed-out. The final audit report is due 120 days after the compact end date. The time that has expired since that due date ranges from 5 months to 17 months with a total unliquidated obligations balance of over $17 million. Untimely de-obligation of funds results in misstated balances or misclassified funds in the statement of budgetary resources.

Recommendations

We recommend that MCC:

21. Timely assess the MCA's need for the remaining compact funds so that the funds could be de-obligated within the timeline in the policy and procedures after the compact expires.

22. Develop and implement a financial management policy that separates the programmatic close-out process from the financial close-out process. This policy should clearly layout the expected timing for de-obligation.

4. Information Systems Controls Need Improvement

All business processes today are impacted in some respects by information systems applications, policies, and controls. Information system is key to financial information collection, classification, allocations, and reporting.

Information systems controls must be in place to ensure that critical data, transactions and programs are processed in a timely manner. These include controls over MCC's general support system used to gain access to the contractor owned financial applications. Our evaluation of the general and application controls of MCC's key information technology infrastructure identified the following control weaknesses, taken together, constitute a significant deficiency.

Security Management

- MCC needs to strengthen personnel out-processing procedures. MCC personnel exit checklists were not maintained in the Staff Track and Reconciliation System (STARS) as required in the MCC Exit Policy and Clearance Procedures. Additionally, while the new exit process had been announced and the technology implemented, the process had not

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been adopted by the stakeholders involved: Human Resources, Contracts, and Office of Security.

- MCC did not properly assess system risks on the agency's general support system, MCCNet and MIDAS system for the fiscal year. For example:
    - MCC did not maintain a current Authorization to Operate (ATO) for the MCCNet General Support System. The ATO expired on June 8, 2012, without MCC completing a reauthorization of the system.
    - MCC did not perform a security impact assessment prior to moving its data center.
    - MCC did not complete a risk assessment to reflect the new data center. The last revision to the risk assessment was dated June 8, 2009.

  In addition, a current risk assessment for the MIDAS system was not completed on an annual basis.

- MCC needs to conduct system security assessments as specified by the National Institute of Standards and Technology (NIST). The fiscal year 2012 security assessment for MCCNet reviewed only two control families from NIST Special Publication 800-53, Revision 3: Access Controls and Media Protection. However, the assessment was not in accordance with the NIST Special Publication 800-37, Revision 1, risk management framework and continuous monitoring.

- MCC needs to ensure all personnel receive security awareness training. MCC did not track users who failed to participate in the daily Tips of the Day. In addition, MCC did not establish a required number of tips a user must view each month or year.

- MCC did not fully implement NIST Special Publication 800-53, Revision 3 into its information system security policies. MCC was in the process of updating the Policy; however, it was not finalized.

- The MCCNet system security plan did not accurately reflect the current information system environment.

Contingency Planning

- MCC did not perform testing of the MCCNet contingency plan for Fiscal Year (FY) 2012. The last test was conducted in February of 2011; however, the test results and lessons learned were not formally documented and reported until November 2011.

Access Controls

- MCC needs to periodically review network accounts. MCC did not perform quarterly reviews of MCCNet group memberships as documented within the MCC Access Control Procedures. In addition, MCC did not review network accounts of users that had never logged into system.

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Configuration Management

- MCC needs to strengthen security controls surrounding patch and configuration management. MCC had procedures in place that use vulnerability scanning software to assist in detecting and reporting security vulnerabilities. However, our evaluation identified critical and high vulnerabilities on MCC hosts that MCC did not identify through its scans.

- MCC did not effectively track and maintain their asset inventory. Asset management personnel did not follow a set of documented procedures for how to manage the asset inventory. In addition, MCC did not conduct periodic wall-to-wall asset inventories.

- MCC did not have documented change management procedures that describe types of changes and levels of testing applied to the changes prior to approval by the Configuration Control Board.

These findings highlight the MCC's lack of compliance with the NIST publications, OMB Circulars, and FISMA requirements as listed below:

OMB Circular A-130, *Management of Federal Information Resources*, Appendix III, states "Agencies shall implement and maintain a program to assure that adequate security is provided for all agency information collected, processed, transmitted, stored, or disseminated in general support systems and major applications."

The Federal Information Security Management Act of 2002 (FISMA) requires that each agency develop an agency-wide information security program that includes:

- Periodic assessments of risk, including the magnitude of harm that could result from the unauthorized access, use, disclosure, disruption, modification, or destruction of information and information systems that support the operations and assets of the organization;
- Policies and procedures that are based on risk assessments, cost-effectively reduce information security risks to an acceptable level and address information security throughout the life cycle of each organizational information system;
- Plans for providing adequate information security for networks, facilities, information systems, or groups of information systems, as appropriate;
- Security awareness training to inform personnel of the information security risks associated with their activities and their responsibilities in complying with organizational policies and procedures designed to reduce these risks;
- Periodic testing and evaluation of the effectiveness of information security policies, procedures, practices, and security controls to be performed with a frequency depending on risk, but no less than annually;
- A process of planning, implementing, evaluating, and documenting remedial actions to address any deficiencies in the information security policies, procedures, and practices of the organization;
- Procedures for detecting, reporting, and responding to security incidents; and
- Plans and procedures for continuity of operations for information systems that support the operations and assets of the organization.

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By not effectively implementing and enforcing IT policies and procedures, there is an increased risk that financial and sensitive information may be inadvertently or deliberately misused and may result in improper disclosure or theft without detection.

Recommendation

We are not repeating our recommendations which are included in the USAID OIG Report titled "Audit of Millennium Challenge Corporation's Fiscal Year 2012 Compliance with Federal Information Security Management Act of 2002," Audit Report M-000-13-001-P, dated November 6, 2012.

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STATUS OF PRIOR YEAR'S FINDINGS AND RECOMMENDATIONS

As required by *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, we have reviewed the status of MCC corrective actions with respect to the findings and recommendations included in MCC's Report on Internal Control for FY 2011. The following analysis provides our assessment of the progress MCC has made through September 30, 2012 in correcting the noted deficiencies.

FY 2011 Findings	FY 2011 Recommendations	FY 2012 Status
I. MCC's Financial Reporting Needs Improvement – Material Weakness	1. Develop and document a financial reporting process that reduces the likelihood of errors, inconsistencies, and inaccuracies and results in efficiencies and effectiveness, consistency, and accuracy of financial data.	Partially Closed. Financial Reporting Process still in draft. Some conditions identified in FY 2011 still exist in FY 2012 and are reported as MW.
	2. Enhance the quality control process to detect errors or improper closeout of accounts through additional check totals, training, and involvement of additional A&F staff members.	Partially Closed. Some conditions identified in FY 2011 still exist in FY 2012 and are reported as MW.
II. Controls over MCC Accrued Expenses, Retentions, and Advances Need Improvement – Material Weakness (MW)	3. Develop an appropriate MCC data store of MCA expense information as required by TR 12.	Partially Closed. Some conditions identified in FY 2011 still exist in FY 2012 and are reported as Significant Deficiency (SD).
	4. Perform similar data validation employed at year-end for each quarter going forward.	Closed – New accrual methodology adopted in FY 2012
	5. Prepare an MCC developed estimate for accrued expenses based upon statistical modeling or alternative that is based on MCC obtained data.	Closed
	6. Record advances in accordance with generally accepted accounting principles.	Closed
	7. Develop and implement a periodic reconciliation process for advances.	Closed
	8. Develop and implement a quarterly certification for advance transactions processed by the MCAs as part of the quarterly data call submission.	Closed

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	9. Modify MCA audit requirements to include testing and reporting of advances transactions.	Partially Closed. MCC proposed changes to MCA Audit Guide to address the testing and reporting of advances transactions. However, the changes have not been finalized and implemented by the MCAs.
III. MCA Required Documentation, including Audit Reports, Quarterly Disbursement Requests and Compact Closure Plans are not Submitted, Reviewed, and/or Approved in a Timely Manner – Significant Deficiency (SD)	10. Collaborate with the OIG and provide the MCA auditors with a document discussing the issues/errors that have led to delays in processing and clearing the audit plans and audit reports in a timely manner.	Closed
	11. Provide comprehensive guidance to MCAs regarding the procurement of firms to perform the FAS audits with a focus on timeliness and completeness of the audit deliverables and potential penalties.	Recommendation Closed. However, certain conditions identified in FY 2011 still exist in FY 2012 and are reported as SD.
	12. Continue to collaborate with the OIG to improve communications regarding audit status and solutions to moving individual audits to completion on a timely basis.	Recommendation Closed. However, certain conditions identified in FY 2011 still exist in FY 2012 and are reported as SD.
	13. Reiterate the program requirements that QDRs are to be accurate and complete and submitted within the required timelines and provide them with information about issues/things that cause delays.	Recommendation Closed. However, certain conditions identified in FY 2011 still exist in FY 2012 and are reported as management letter (ML).

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	14. Review their current guidelines for submission of CCPs to determine if the timelines is reasonable and realistic. In addition, DCO should work closely with MCAs to develop and compile a compact closure plan and resolve any outstanding items in advance of compact closure.	Recommendation Closed. However, certain conditions identified in FY 2011 still exist in FY 2012 and are reported as ML.
IV. Reconciling Fund Balance with Treasury – SD	15. Continue to follow USAID's progress towards elimination of cash balance differences between USAID and Treasury and timely clearing of suspense account items in order to monitor MCC's risks of potential misstatements.	Recommendation Closed. However, the condition still exist in FY 2012 and is reported as ML.

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CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Exhibit 4

November 13, 2012

Mia Leswing, CPA, CISA, CGFM, Partner
CliftonLarsonAllen, LLP
4250 N. Fairfax Drive
Suite 1020
Arlington, VA 22203

Richard J. Taylor
Deputy Assistant Inspector General/Audit
Millennium Challenge Corporation
1401 H Street, NW, Suite 770
Washington, DC 20005

Dear Ms. Leswing and Mr. Taylor:

MCC has reviewed the draft audit report received November 9, 2012. In response to audit findings characterized as material weaknesses and significant deficiencies, as well as the associated recommendations, MCC has the following comments:

Material Weakness: Ineffective and Inefficient Interrelationship Among Software, Personnel, Procedures, Controls and Data within MCC's Financial Management Systems

Recommendations from the auditors:

1. Perform a comprehensive review and determine whether the service provider's financial management system is substantially in compliance with the federal financial management systems' requirements and meeting MCC needs. As part of this review determine if a separate grants management system that focuses on program administration that interfaces with the core financial system is needed.
2. Investigate and correct the causes for the underlying systems errors and limitations that prevent or delay the recording, processing, and summarizing of accounting transactions.
3. Review USGGL transaction posting models so that all routine accounting transactions are included in the normal accounting processes. Manual adjusting journal entries should be used for limited transactions like one-time entries. All valid recurring entries that are currently entered manually should have transaction codes set-up to prevent posting errors.
4. Hard code key cells in the excel spreadsheets used in preparing and generating the financial statements to prevent unintentional or inadvertent changes.
5. Limit access and ability to make changes to the workbook to a few personnel. Assign a staff and a designate as primarily responsible and accountable for the workbook.
6. Create a log to document changes to the workbook, the date of change, the person making the change, and the changes made.
7. Investigate the use of alternative approaches such as the use of a financial statement generation software tool or other financial management system that can interface with the trial balance or the core financial system and automatically generate the financial statements.

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8. Develop a comprehensive financial statements review process that details specific steps performed, results of such reviews, steps taken to resolve discrepancies noted, and related management resolution.
9. Implement an effective management review using the comprehensive review process developed in recommendation 8 to ensure that all transactions for the accounting period are accurately and completely reflected in the financial statements, current year beginning balances agreed to prior year audited balances, reconciling items are recorded timely and others. Such management reviews should be performed quarterly and at year-end timely with evidence of management sing-off signifying levels of reviews performed.
10. Cross-train MCC financial staff on the financial statements preparation process to ensure that there is more than one person knowledgeable and can prepare the financial statements.

Response from MCC:
MCC concurs with recommendations 1 through 10.

Significant Deficiency: Validation Control over Grant Accrual Estimates Needs to be Strengthened
Recommendations from the auditors:

11. Perform the grant accrual look back analysis on a quarterly basis. The look back analysis methodology and results should provide MCC sufficient information to explain unusual variances between actual and estimates, or support updating the current grant accrual methodology. Such periodic assessment of the adequacy of the grant accrual methodology should be documented and supported by data analysis. The liability amount is subject to risk that actual subsequent disbursement account may be significantly different from management's estimate. When this occurs, management should further analyze the drivers/factors to ensure the validity and reasonableness of the estimation methodology.
12. Update the Expense Accruals Policy and Procedures to reflect the change in the methodology.
13. Consider developing audit procedures for the MCA audit to compare spending authority request amount against actual expenses, and investigate and document significant variances. The results should be provided to MCC and used this information collected from the MCA audits as data store to validate or enhance the current methodology.
14. Continue to enhance the accrual methodology.

Response from MCC:
MCC concurs with recommendations 11 through 14.

Significant Deficiency: Monitoring Control over Funds Provided to Millennium Challenge Accounts (MCAs) Needs Improvement

Recommendations from the auditors:

15. MCC management should have control over how these audits should be conducted to meet its financial and programmatic accountability, needs and requirements. MCC management should collaborate with USAID OIG to clarify and document management roles, responsibilities, and performance standards and the USAID OIG oversight roles with regards to MCA audits.
16. MCC needs to evaluate its resources, capability, and ability to monitor and review the quality and performance of the audits and the audit firms, to track and conduct follow-up of corrective action plans with the MCAs.
17. Utilize the QFRs and the monthly reconciliations as monitoring tools over the MCA's financial reporting process and validating MCC's financial records. To be effective

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monitoring tools, the re-designing of the QFR form and the development and documentation of the monthly reconciliation process should ensure that relevant data and information are reported by the MCAs and reported timely.

18. Ensure that MCA reconciliations are provided to MCC and reviewed to investigate material variances and make corrections, if any.
19. Require the MCA audit firms to test the design and effectiveness of the MCA's internal control over the QFRs and the monthly reconciliation and to test for the accuracy of the balances and reconciliation.
20. Develop and implement reconciliation procedures to document the complete reconciliation between the MCA's final QFR and MCC's records.
21. Timely assess the MCA's needs for the remaining compact funds so that the funds could be de-obligated within the timeline in the policy and procedures after the compact expires.
22. Develop and implement a financial management policy that separates the programmatic close-out process from the financial close-out process. This policy should clearly layout the expected timing for de-obligation.

Response from MCC:
MCC concurs with recommendations 15 through 22.

Significant Deficiency: Information Systems Controls Need Improvement
Recommendations from the auditors:

23. Repeat recommendations from the FISMA Report.

Response from MCC:
MCC concurs with recommendations in the FISMA Report

MCC will be addressing each recommendation as part of a comprehensive corrective action plan beginning in the first quarter of FY 2013 with the intent to develop and implement necessary changes as soon as possible.

Sincerely,
MILLENNIUM CHALLENGE CORPORATION
By:
Chantale Wong
Vice President, Administration and Finance, and
Chief Financial Officer
Millennium Challenge Corporation

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Page 5: *Kwamti Pura neighborhood of Zanzibar Town, Zanzibar, Tanzania,* Jake Lyell for MCC
Page 20: *Ben Ka Di Fish Smoking Center in Niassan village, Burkina Faso,* Jake Lyell for MCC
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Reducing Poverty Through Growth

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