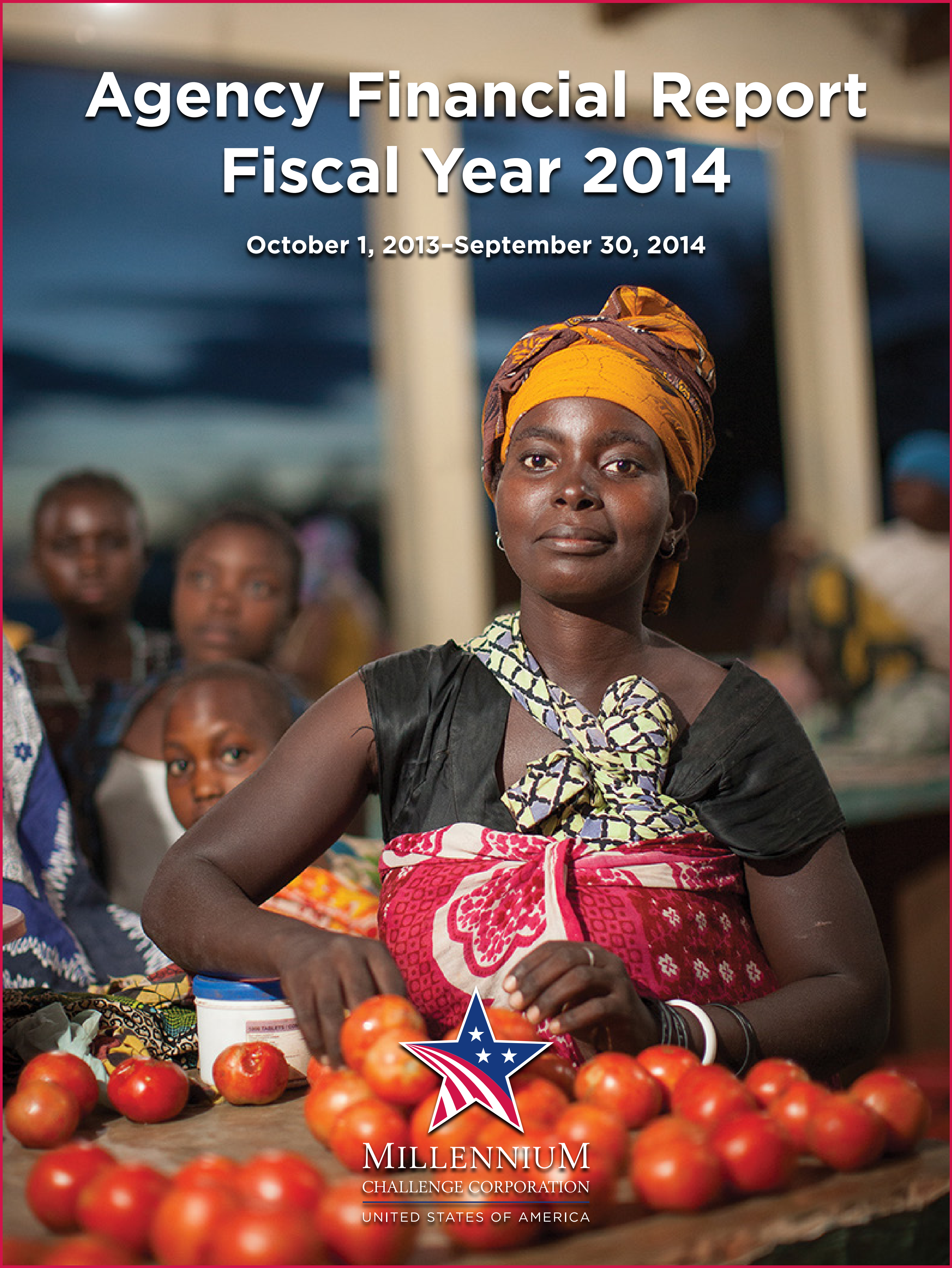
Agency Financial Report Fiscal Year 2014

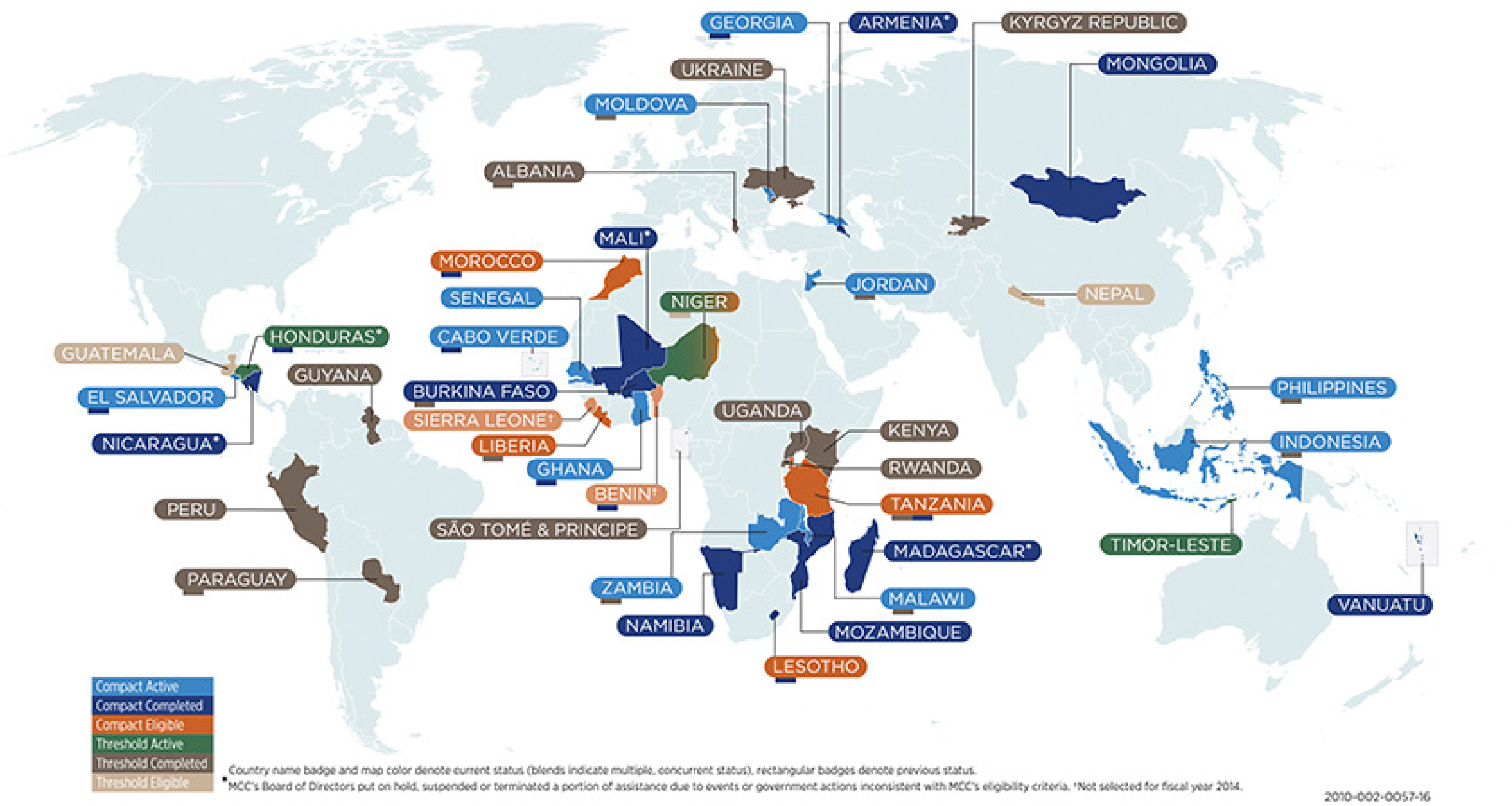
October 1, 2013–September 30, 2014



MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

MCC Partner Countries — Compacts and Threshold Programs

MCC has worked with partners in the countries shown on the map below to help reduce poverty through economic growth.



On the Cover

A woman sells vegetables at a nighttime market lit by solar power in the village of Msimba in the Kigoma region of western Tanzania. MCC's solar energy programs have brought electricity to markets and dispensaries in Msimba and dozens of other markets, schools, hospitals, and dispensaries across the region.

Millennium Challenge Corporation: Kigoma Region, Tanzania

November 2, 2012

Photo by Jake Lyell for MCC

MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Agency Financial Report

Fiscal Year 2014

October 1, 2013 – September 30, 2014

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Introduction

The Millennium Challenge Corporation's (MCC's) Agency Financial Report (AFR) for fiscal year (FY) 2014 provides fiscal and high-level performance results that enable the President, Congress and the American people to assess MCC's performance for the reporting period October 1, 2013, through September 30, 2014. It provides an overview of MCC's programs, accomplishments, challenges and management's accountability for the resources entrusted to MCC. This report was prepared in accordance with the requirements of the Office of Management and Budget's (OMB's) Circular No. A-136, *Financial Reporting Requirements.*

MCC has chosen to produce an AFR and an Annual Performance Report (APR). MCC will include its FY 2014 APR in the Corporation's Congressional Budget Justification, which it will post on MCC's website in February 2015. Together, the AFR and APR present the results of the annual assessment of MCC's program leadership and stewardship of the resources entrusted to it. They provide a comprehensive snapshot of the most important financial information related to MCC's programs. MCC also provides an Annual Report and other documents regarding its activities to the Congress, to its Board of Directors, to stakeholders and to the public on its website.

For more information about MCC, visit its website at: http://www.mcc.gov

Organization of This Report

This AFR includes a message from the Chief Executive Officer (CEO), followed by three sections and appendices.

- **Section I: Management's Discussion and Analysis** describes MCC's mission and organizational structure, strategic goals and highlights of accomplishments, analysis of the financial statements and stewardship information, and summaries of its systems, controls and legal compliance.
- **Section II: Financial Section** contains a message from the Vice President, Department of Administration and Finance and Chief Financial Officer (CFO), the financial statements and notes and the independent auditors' report.
- **Section III: Other Information** includes the Inspector General's (IG's) summary of top management challenges, MCC management's response to those challenges, a summary of MCC's financial statement audit and management assurances and MCC's improper payments report, required by the Improper Payments Information Act, as amended by the Improper Payments Elimination and Recovery Act.
- **Appendices** include a list of acronyms used in this report (Appendix A), a summary of MCC's compact and threshold programs (Appendix B), MCC's country selection process and criteria (Appendix C) and a list of useful websites for additional information about MCC (Appendix D). The website list includes the web addresses for all hyperlinked documents in the text of this report.

MCC Welcomes Your Comments

MCC welcomes comments and suggestions regarding this report.
Please contact MCC at:

https://www.mcc.gov/pages/contact

or write to:

875 Fifteenth Street, NW
Washington, DC 20005-2221
(202) 521-3600

The Millennium Challenge Corporation is an innovative and independent U.S. foreign aid agency that is helping lead the fight against global poverty.

November 12, 2014

Message from the Millennium Challenge Corporation's Chief Executive Officer

As the Millennium Challenge Corporation (MCC) marks its milestone 10th anniversary, I am honored to lead this groundbreaking organization at this pivotal time and share with you our 2014 Agency Financial Report (AFR).

Charged with the singular mission of fighting global poverty through economic growth, MCC delivers influence and impact beyond its small size by partnering with countries committed to sound democratic and economic governance. These are partners who are willing to methodically analyze their constraints to growth as the first step to designing and implementing their own projects to deliver results that benefit the poor.

MCC's investments over the last decade in food security and energy security, in critical infrastructure to expand trade and commerce, in clean water, sanitation, health, and education to create a more productive workforce, and in land rights and gender equality have benefited the poor and fueled the conditions for lasting growth. These investments also make countries more attractive to private businesses—the engine of economic growth—and increase their confidence to invest. Ultimately, we want to see aid recipients become investment partners.

During fiscal year 2014, MCC contributed to these goals by completing compacts with Burkina Faso and Namibia and signing both Ghana's Power Compact, a $498.2 million grant to transform the country's power sector and attract private sector investment, and the $277 million El Salvador Investment Compact, focused on improving transportation infrastructure, human capital and the country's investment climate. We made further investments in data transparency, including our role in helping to launch the Governance Data Alliance. Contributing to whole-of-government development efforts, we are supporting such Obama administration priorities as Power Africa, the African Growth and Opportunity Act and Partnership for Growth.

Now, as we chart the course ahead for the next decade, we want to remain an agency at the defining edge of development, making effective, efficient and evidence-driven decisions not only about who our partners should be but also about how we should operate. I am eager to explore regional investment, alternative financing mechanisms and using compacts as a platform for anchoring additional U.S. Government investments in targeted sectors in targeted places.

The financial and performance information presented in this AFR helps tell the story of MCC's impact to date in delivering best practices in development to end global poverty, and is fundamentally complete and reliable.

I am pleased to note that in FY 2014, MCC received an unmodified opinion on its financial statements for the fourth year in a row. The opinion rendered by MCC's auditors reaffirms our dedication to fulfilling our fiduciary responsibility to the American people to manage the resources entrusted to us in compliance with applicable laws and rigorous accounting standards.

Furthermore, please see my annual assurance statement, also included in this report, for information regarding MCC's compliance with appropriate financial laws and regulations.

I invite our stakeholders to continue following MCC's work, sharing critical feedback and holding us accountable to make progress in the fight against global poverty. Building on our first decade, MCC is committed to ongoing improvements and innovation to contribute to U.S. development efforts and make a measurable and sustained difference in the lives of the world's poor.

/ s /

Dana J. Hyde
Chief Executive Officer

Management's Discussion and Analysis

A female construction worker in a small village in the Visayas region in the Philippines helps build an MCC-funded community daycare center. One of six women who take turns weekly to help complete the center, a lifelong dream of the people in the village.

Mission and Organizational Structure

Mission

The Millennium Challenge Act of 2003, contained in Title VI, Division D, of Public Law 108-199 (the Consolidated Appropriations Act, 2004), established MCC as a wholly-owned Government corporation as defined by the Government Corporation Control Act. MCC's mission is to reduce poverty through assistance to further economic growth in developing countries. MCC selects only those countries committed to strengthening good governance, encouraging economic freedom and promoting investments in people. To ensure accountability, MCC rigorously plans, tracks and monitors results to determine the long-term effect of investments.

Individual countries develop assistance programs to build their own capacity for delivering solutions to their citizens. These programs have focused on policy, institutional and infrastructure improvements in such sectors as energy, agriculture and irrigation; transportation (e.g., roads, bridges, ports); water supply and sanitation; access to health; finance and enterprise development; anticorruption initiatives; land rights and access; and access to education.

MCC provides assistance through two types of large-scale grants to eligible countries:

- A ***compact*** is a large, 5-year grant to a country that meets MCC's eligibility criteria. It funds specific programs targeted at reducing poverty and stimulating economic growth. To obtain a compact, a country identifies its priorities and develops a proposal in broad consultation with civil society; MCC teams then work in close partnership to help the country refine a program. When MCC awards a compact, the country sets up a local accountable entity (Millennium Challenge Account, or MCA) to manage and oversee all aspects of implementation.

- A ***threshold program*** is a country-driven partnership that aims to assist a country to become eligible for an MCC compact by supporting policy and institutional reforms that target binding constraints to economic growth. MCC uses a rigorous, structured diagnostic process to develop threshold programs, followed by program design and implementation.

MCC is just one part of the U.S. international development program. To this end, MCC works closely with the Department of State and the United States Agency for International Development (USAID) to develop and implement its programs. Strengthening the next generation of emerging markets that will trade and do business with American companies can lead to job creation in the United States. As emerging economies prosper, they become more stable and secure, which promotes America's national security interests.

Appendix B provides a summary of MCC compact and threshold programs.

Values

MCC articulated a set of corporate values in FY 2013 to serve as the foundation of MCC's corporate culture and improve agency performance through enhanced staff engagement and team effectiveness. MCC's values define how individuals and the institution behave on a daily basis in pursuit of the mission. The values guide how MCC and MCC staff make decisions, set priorities, address challenges, manage tradeoffs, recruit and develop staff, and work together with country partners and stakeholders. Taken together, MCC's values are **CLEAR**:

Embrace Collaboration

We work together toward clear, common goals with a spirit of creativity and teamwork. We believe that bringing different perspectives to the table leads to finding the best solutions.

Always Learn

We question assumptions and seek to understand what works, what doesn't and why. We recognize that failing to reach a goal can be an important source of learning, and we apply and share those lessons broadly.

Practice Excellence

We envision MCC as a leader in global development, and we have high standards for ourselves, our partner countries, and the investments we make. We bring out the best in ourselves and in each other to advance the fight against global poverty.

Be Accountable

We own our actions, are honest about our limits and missteps, and hold ourselves and each other responsible for good performance. We are transparent and explain our decisions.

Respect Individuals and Ideas

We are inclusive, act with humility and value diverse ideas. We listen to each other and foster strong working relationships with our colleagues at MCC, in our partner countries and in the development community.

Country Selection Process

The hallmark of MCC's country selection process is transparency. MCC uses a four-step process to select countries as eligible for assistance:

1. ***Identify Candidate Countries.*** MCC identifies candidate countries for the fiscal year based on per capita income and their legal eligibility to receive U.S. economic assistance.
2. ***Publish MCC's Selection Criteria and Methodology for Country Selection and Accept Public Comment.*** MCC submits a report to Congress describing the criteria and the methodology and including the indicators that MCC's Board of Directors will use to select eligible countries.

3. ***Issue Candidate Country Scorecards.*** Before the MCC Board meets to select compact-eligible countries, MCC publishes country performance scorecards on its public website for all candidate countries and countries that would be candidates but for legal prohibitions.
4. ***Select Countries Eligible for MCC Program Assistance.*** From the pool of candidate countries, the MCC Board selects eligible countries according to the methodology described above and submits a report to Congress no later than 5 days after the determination. These countries are then eligible to begin developing compact proposals for MCC's consideration.

Appendix C describes the selection process and the criteria in detail. For FY 2014, MCC used the following criteria, which fall under one of three categories: Ruling Justly, Investing in People and Encouraging Economic Freedom. The table below summarizes MCC's selection criteria.

MCC Selection Criteria

Ruling Justly	Investing In People	Encouraging Economic Freedom
• Civil Liberties • Political Rights • Control of Corruption • Government Effectiveness • Rule of Law • Freedom of Information	• Immunization Rates • Public Expenditures on Health • Primary Education Expenditure • Girl's Education – Primary Education Completion (Lower Income Countries only) – Secondary Education Enrollment (Lower Middle Income Countries only) • Child Health • Public Expenditure on Primary Health – Child Health – Natural Resource Protection	• Business Start-up • Land Rights and Access • Trade Policy • Regulatory Quality • Inflation • Fiscal Policy • Access to Credit • Gender in the Economy

If you are reading a paper copy of this document, you will find more information on selection indicators at http://www.mcc.gov/pages/selection/indicators

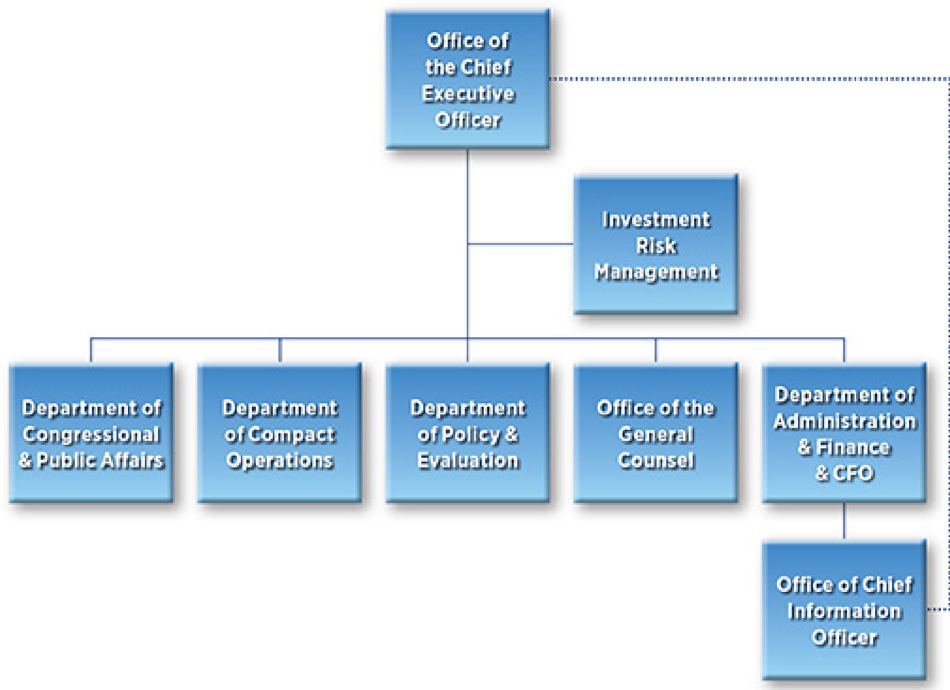
MCC's guiding principle is that aid is most effective when it reinforces good governance and policies that promote economic growth. In making its determinations, MCC's Board of Directors considers three factors: (1) policy performance as defined by policy indicators and supplemental information, (2) the opportunity to reduce poverty and generate economic growth in the country and (3) the funds available to MCC. If applicable, the Board also considers a country's performance on a previous threshold program or compact.

MCC identifies countries eligible to receive MCC funds through a rigorous assessment process prior to the MCC Board making its selections. This process uses indicators and supplemental information to assess a country's policy environments to determine where MCC funding will be effective in reducing poverty and promoting economic growth.

The country selection process is continuous; MCC reviews all of its performance indicators annually to ensure it is using the best measures, making changes or refinements if it identifies better indicators or improved sources of data. In addition, MCC continually monitors its partner countries' policies, and in the event of a significant policy decline or policy reversal, or a pattern of actions inconsistent with the eligibility criteria, MCC can evoke its policy on suspension and termination.

Organizational Structure

The CEO, a member of the nine-member Board of Directors, manages MCC. The Secretary of State, the Secretary of the Treasury, the U.S. Trade Representative, and the USAID Administrator serve on the Board along with four private sector representatives appointed by the President of the United States with the advice and consent of the U.S. Senate. The Secretary of State is the Chair of the Board and the Secretary of the Treasury is the Vice Chair. MCC's organization chart is shown below.



MCC has six departments:

1. The **Office of the Chief Executive Officer** is responsible for the overall management of MCC. Principal officers include the CEO, the Chief of Staff, the Senior Executive Advisor, the Senior Advisor, and the Executive Secretary. This office provides executive leadership and strategic direction for the agency; coordinates activities and communications across departments; manages the agency's portfolio investment and risk assessment; manages the Investment Management Committee; and manages the official correspondence, scheduling and interagency information for the CEO.

2. The **Office of the General Counsel** provides advice to MCC's Board of Directors and MCC staff on all legal issues affecting MCC, its programs, policies and procedures; conducts compact negotiations and assists with legal aspects of compact implementation; provides advice on issues affecting the internal operations of MCC, such as personnel law, government contracts, fiscal law and corporate records management; provides statutory interpretation; performs the function of Corporate Secretary to the MCC Board of Directors; and manages MCC's ethics program, providing related training and guidance to staff.

3. The **Department of Congressional and Public Affairs** manages MCC's relationship with the U.S. Congress, other U.S. Government agencies, the media, universities, non-governmental organizations, "think tanks," the private sector and other key groups interested in MCC's mission. This department handles all media inquiries and interview requests, manages the MCC speaker's bureau, coordinates all public events, serves as a liaison to the staff of MCC's Board of Directors, maintains MCC's public and internal websites and disseminates information to the public through statements, press releases and speeches.

4. The **Department of Administration and Finance and Chief Financial Officer** plans and directs all activities related to financial management and budgeting; manages MCC's human resources; oversees information technology (IT) infrastructure and services; enters into and manages all MCC contracts, acquisitions and grants; ensures personnel and physical security; coordinates and manages MCC's facilities and provides administrative services; maintains official corporate records; coordinates audit interactions with the IG and the Government Accountability Office;

Students gather between classes at Shikudule Combined School in Oshana Region, Namibia. At the all-grade levels school, which was renovated by MCC, students, teachers and classrooms received laboratory equipment, computers and textbooks.

Millennium Challenge Corporation: Namibia

March 10, 2014

Photo by Andrew Ladson, Congressional and Public Affairs and coordinates and ensures timely and relevant reporting of performance data on compact programs. There is a "dotted" line relationship between the Chief Information Officer and the CEO.

5. The **Department of Compact Operations (DCO)** is responsible for managing the day-to-day implementation of compact programs, the development of new compact programs and the relationships with MCC partners. DCO staff provide political and regional expertise and rigorous oversight of U.S. resources to address constraints to economic growth and to reduce poverty. DCO staff have expertise in many critical areas, including education, fiscal accountability, infrastructure, agriculture, land policy, procurement, environmental and social performance, gender integration, private sector engagement and health.

   The department divides the management of the MCC compact portfolio into two regional divisions: Africa and Europe, Asia-Pacific and Latin America, and two technical divisions: Sector Operations and Infrastructure, Environment and Private Sector. DCO also works with other development agencies and the private sector to coordinate efforts within partner countries.

6. The **Department of Policy and Evaluation (DPE)** is responsible for the institutional oversight of policy and best practices related to country eligibility, policy improvement and reform, economic analysis, monitoring and evaluation and learning from evidence. DPE manages MCC's country selection process, country monitoring, the threshold program and independent evaluation. DPE and DCO share responsibility for economic analysis and monitoring and evaluating MCC compacts. DPE formulates strategies that leverage MCC impact with other U.S. Government agencies, the international development community and nongovernmental organizations.

MCC is a small Government corporation with its headquarters in Washington, DC. The table below shows Federal employee staffing levels since FY 2011.

MCC Staffing — Full Time Equivalent*

	FY 2014	FY 2013	FY 2012	FY 2011
Headquarters	263	268	259	251
Overseas	21	25	30	31
Total Employees	**284**	**293**	**289**	**282**

**Staffing report based on Standard Form (SF)-113A and SF-113G reporting of full-time equivalency calculations based on quarter 4 of each fiscal year.*

Performance Goals, Objectives and Results

MCC will provide an APR as part of its Congressional Budget Justification, which will be available in February 2015. A high-level summary of MCC's strategic direction and performance during FY 2014 follows.

Strategic Direction

MCC's mission is to reduce poverty by supporting sustainable economic growth in selected developing countries that demonstrate a commitment to sound policy in the areas of democratic governance, economic freedom and investment in people. This is a long-term mission, focused on addressing issues of persistent poverty and underdevelopment in low and lower-middle income countries facing critical challenges of capacity, resources and institutional weakness. MCC seeks through its programs to demonstrate the effectiveness of linking foreign development assistance to demonstrable economic outcomes. In FY 2014, MCC activities addressed the four key principles outlined in MCC's Strategic Plan 2011–2015:

1. **Results matter** — success is measured by results, not inputs.
2. **Policies matter** — good policies are critical to achieving sustainable economic growth.
3. **Country ownership matters** — country partner responsibility for results is essential for achieving sustainable development and reducing dependence on foreign assistance.
4. **Accountability matters** — without accountability there is no true responsibility and without transparency there is no accountability.

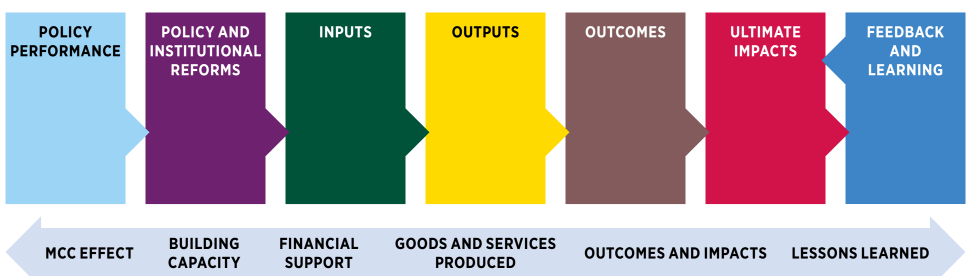
To implement these principles, MCC identified the following broad themes for the 5-year period covered by its strategic plan:

1. Apply effective instruments for tracking results that will support transparent results reporting.
2. Focus on policy reform as the best guarantor of sustainable development.
3. Leverage MCC's assets by working with partners to enhance the impact and reach of MCC programs, especially with the private sector.
4. Integrate gender and social assessment into all aspects of program design and implementation.
5. Ensure that MCC has the organizational capacity to respond effectively to evolving challenges.

Prior to the beginning of each fiscal year, MCC carries out an exercise focused on identifying priority areas of concentration for that fiscal year. These areas of concentration elaborate upon, but do not replace the overarching principles. The process for identifying them is both top-down and bottom-up. Informed by feedback from staff at all levels, the senior management team meets to discuss experiences over the past year in relation to the strategic plan and the previous year's goals and priorities. It determines what the specific areas of attention should be for the coming year. Each department carries out an intensive departmental planning exercise to clarify its detailed goals and objectives. Senior management reviews the plans to ensure that the corporate and departmental goals and priorities are clear and integrated effectively. These goals and priorities serve as the basis for individual performance planning as well as for management of the agency's business during the course of the year.

MCC's Approach to Performance Measurement

MCC is committed to delivering results throughout the entire lifecycle of its investments. From before investments begin to their completion and beyond, MCC's robust and comprehensive results framework measures, collects and reports inputs and outputs (that indicate whether projects are on track), interim outcomes (as programs reach completion) and impacts as measured through independent evaluations. MCC also tracks policy reforms associated with a country's compact eligibility and program. The figure below shows the framework; the table that follows explains each step.



MCC's Results Framework

Step	Description
Policy Performance	MCC works to track policy reforms made to improve performance on MCC's indicators. Eligibility for an MCC compact is regarded as a seal of approval, signaling to private investors that the country is well governed and open for business. MCC has the option to suspend or terminate funding if a partner country's policy performance deteriorates significantly. This option to halt funding, which to date MCC has used in response to governance concerns, creates an incentive for ongoing policy and implementation performance.
Policy and Institutional Reforms	During compact development, MCC and partner countries look closely at the policy and institutional environment to assess areas that might limit investments' impact and sustainability and work with partner countries to plan appropriate policy and institutional reforms. These can be changes to national policies, laws, regulations, or even ways of doing business, and often focus on building capacity within existing national institutions.
Inputs	MCC's primary input is financial support for investments that promote poverty reduction and economic growth. MCC also contributes technical/professional support for oversight and policy dialogue. MCC and its partner countries use analyses of key constraints to growth, and cost-benefits and beneficiaries to identify which investments have the biggest impact in terms of raising local incomes and generating long-term returns measured in economic benefits. To safeguard MCC investments, partner countries must adhere to international standards in financial management and procurement. Where necessary, they use external financial and procurement agents.
Outputs	Outputs measure the goods or services produced by a program (e.g., kilometers of roads or irrigation canals built, farmers trained or land titles issued). MCC and its partner countries use monitoring and evaluation plans to establish targets and track progress on outputs. Transparent reporting on these outputs is key for accountability and for making mid-course corrections as needed.
Outcomes	Outcomes measure the medium-term effects of a program, such as increased traffic volume on improved roads, new business investments, increased production of high-value crops, increased access to electricity or clean water, or increased school attendance. MCC and partner countries use monitoring and evaluation plans to track outcomes since they are the drivers of the increased income that MCC ultimately aims to achieve.
Ultimate Impacts	The ultimate result MCC is committed to producing—and being able to attribute to its investments—is increased incomes among poor people in developing countries. MCC wants to know if incomes went up because of an MCC investment, what worked best to increase incomes and if the increases were achieved in a cost-effective way. Where the potential to learn is greatest, MCC uses independent impact evaluations to answer these questions, often comparing results from the people who participated in MCC-funded programs to those who did not. This indicates whether gains were the direct result of MCC's investment. MCC also uses performance evaluations to answer qualitative questions, such as how is a project being implemented and whether expected results are occurring.
Feedback and Learning	MCC applies lessons learned to maximize development effectiveness. This involves working with partner countries to identify and address implementation challenges, to keep current investments on track and to inform the design and implementation of future investments. MCC is committed to transparently sharing the results of all evaluations, even when they reveal that MCC investments did not achieve planned targets. This is essential for both accountability and learning. MCC has opened its portfolio to scrutiny and is testing a variety of implementation and evaluation approaches. MCC's experience will foster learning internally, within the U.S. Government and globally both about what programs work best to increase incomes, and what evaluation approaches work best to measure impact.

If you are reading a paper copy of this document, you will find MCC's complete monitoring and evaluation data by sector report at the following MCC website: http://www.mcc.gov/pages/results/m-and-e

Building on the foundation of strong monitoring systems and self-evaluations, MCC-financed independent evaluations are the most rigorous mechanism for fulfilling MCC's commitment to accountability and learning. It is common in the development community to focus on inputs (e.g., funds dedicated to farmer training) and outputs (e.g., the number of farmers trained), and increasingly on some intermediate outcomes (e.g., the rate that trained farmers apply the improved cultivation techniques). MCC frequently takes this focus a step further by applying evaluation techniques to determine if a link exists between these outcomes and the ultimate impact on household incomes. Independent evaluations test the assumptions underlying the program logic and are the primary mechanisms for measuring whether or not that link exists.

MCC invests in two different types of independent evaluations: impact and performance. Impact evaluations make it possible to know whether the MCC investment caused the observed impacts specifically or whether the impacts were the result of external factors that affected program participants and non-participants (e.g., increased market prices for agricultural goods, national policy changes or favorable weather conditions). Impact evaluations compare what happened with the MCC investment to what would have happened without it, through use of a counterfactual.

Performance evaluations also are valuable tools for estimating the contribution of MCC investments to changes in trends for outcomes, including household income. Performance evaluations are useful for comparing changes in the situation before and after MCC's investment and provide details on how an investment might have contributed to changes in outcomes and, very importantly, why or why not.

Students participate in MCC-funded technical and vocational education and training in Mongolia.

In early FY 2013, MCC published the results of the first five impact evaluations, revealing critical learning on how MCC can improve operations and independent evaluations moving forward. As of the end of FY 2014, MCC is investing in more than 200 independent evaluations across all sectors, including impact and performance evaluations. In early 2014, MCC launched its online MCC Evaluation Catalog, which contains public-use evaluation materials including data sets, final reports and design reports. The catalog will continue to expand its coverage of MCC evaluations in FY 2015.

Compact Program Amounts and Results

Since MCC began operations, 25 countries have received funding through 29 compacts (Ghana, El Salvador, Cabo Verde and Georgia have signed two compacts each) and 22 countries have received funding through 24 threshold programs (Albania and Paraguay each signed two). Burkina Faso, Honduras, Indonesia, Jordan, Malawi, Moldova, Philippines, Tanzania and Zambia have signed both compacts and threshold programs. MCC issues Quarterly Status Reports that provide a comprehensive qualitative and quantitative snapshot of each compact project, its commitments and expenditures and its activities.

In FY 2014, MCC signed new compacts with Ghana (August 5, 2014) and El Salvador (September 30, 2014), and reached the end of the compact term for Burkina Faso and Namibia. The following table displays signed grant totals, net of deobligated amounts, for each country through September 30, 2014.

Beneficiaries of MCC's investment in El Salvador's Northern Zone pose for a portrait.

MCC Compact Grants at End of Fiscal Year 2014 (amounts in thousands)	
Compact Country	**Grant Amount**
Armenia[1]	$ 176,550
Benin[1]	301,810
Burkina Faso[1]	480,944
Cabo Verde[1]	108,512
Cabo Verde II	66,230
El Salvador[1]	449,567
El Salvador II*	277,000
Georgia[1]	387,179
Georgia II	140,000
Ghana[1]	536,289
Ghana II*	498,200
Honduras[1]	204,015
Indonesia	600,000
Jordan	275,100
Lesotho[1]	358,046
Madagascar[1]	85,595
Malawi	350,700
Mali[1]	435,597
Moldova	262,000
Mongolia[1]	269,002
Morocco[1]	650,164
Mozambique[1]	447,905
Namibia[1]	304,478
Nicaragua[1]	112,703
Philippines	433,910
Senegal	540,000
Tanzania[1]	694,546
Vanuatu[1]	65,404
Zambia	354,758
TOTAL	**$ 9,866,204**

These compacts have not entered into force.
[1]*These compacts have been completed.*

MCC aggregates results in key sectors to measure progress in those areas across compacts. Currently, MCC calculates aggregate results on a quarterly basis in five categories: roads, agriculture and irrigation, water and sanitation, education, and property rights and land policy (land).

MCC works with the development community to reassess its indicators. MCC may complete early process-level indicators, such as contract dollars disbursed, more quickly than other indicators. The actual construction of the road, for example, will take more time and will be a more relevant indicator as time passes.

The following table presents MCC's program results by sector on select indicators as of June 30 of 2014, 2013 and 2012. The table aggregates country-specific targets and performance data by sector. It represents only a fraction of the performance data that MCC collects and assesses on a quarterly basis. MCC and MCC's partner MCAs collaborate to establish these targets. MCC assesses performance data across all compact programs on a quarterly basis and, where necessary, takes action to address deficiencies, mitigate risks and ensure that the compacts use U.S. taxpayer funding effectively and responsibly.

MCC posts additional data on these five categories in the results pages on its website at the address shown in Appendix D, Useful Websites.

Program Results by Sector on Select Indicators for FYs 2014, 2013 and 2012

Sector	Indicator	Cumulative Target Through FY 2014	Actual			Performance on Targets†			Countries Tracked
			June 30, 2014	June 30, 2013	June 30, 2012	June 30, 2014	June 30, 2013	June 30, 2012	
Roads	Value of signed contracts for road works (dollars in millions)	$2,213	$2,355	$2,329	$1,794	106%	110%	117%	Armenia Burkina Faso Cabo Verde El Salvador Georgia Ghana Honduras Mali Moldova Mongolia Mozambique Nicaragua Philippines Senegal Tanzania Vanuatu
	Kilometers of roads under works contracts	3,857	3,973	3,719	3,168	103%	103%	90%	
	Kilometers of roads completed	3,190	2,444	1,929	1,595	77%	64%	96%	

Program Results by Sector on Select Indicators for FYs 2014, 2013 and 2012

Sector	Indicator	Cumulative Target Through FY 2014	Actual			Performance on Targets†			Countries Tracked
			June 30, 2014	June 30, 2013	June 30, 2012	June 30, 2014	June 30, 2013	June 30, 2012	
Agriculture and Irrigation	Hectares under new or improved irrigation	226,202	120,063*	138,753	116,460	53%	54%	97%	Armenia Burkina Faso Cabo Verde El Salvador Georgia Ghana Honduras Indonesia Madagascar Mali Moldova Morocco Mozambique Namibia Nicaragua Senegal
	Value of agricultural and rural loans (dollars in millions)	$82	$87	$85	$83	101%	102%	134%	
	Farmers trained	281,862	271,173	244,481	202,351	96%	105%	96%	
	Enterprises assisted	3,528	4,137	3,733	NA**	117%	114%	NA**	
Water and Sanitation	Value of signed contracts for water and sanitation works (dollars in millions)	$507	$574	$447	$285	113%	112%	110%	Cabo Verde II El Salvador Georgia Ghana Jordan Lesotho Mozambique Tanzania Zambia
Education	Students participating	255,525	228,847	200,380*	244,762	89%	99%	91%	Burkina Faso El Salvador Ghana Mongolia Morocco Namibia
	Facilities completed	781	745*	839	805	95%	99%	95%	
	Value of signed contracts for construction and/or equipping of educational facilities (dollars in millions)	$165	$179	$166	$115	108%	101%	93%	
Land	Stakeholders trained	26,897	24,902	26,867	19,301	93%	105%	74%	Benin Burkina Faso Cabo Verde II Ghana Lesotho Madagascar Mali Mongolia Mozambique Namibia Nicaragua Senegal
	Land administration offices established	249	191	168	NA**	76%	84%	NA**	

†Based on the cumulative target for that year.

**Data declined due to Monitoring & Evaluation Plan revision or data revision by MCA counterpart.*

***In June 2013, MCC revised its measures for agriculture and irrigation, and land. Data for these measures will be available in future reporting.*

Analysis of MCC's Financial Statements

At the end of the fiscal year, MCC prepared four basic financial statements with accompanying notes and presented them to the USAID Office of Inspector General (OIG) for audit by an independent accounting firm. The Financial Section of this report contains the financial statements and notes, and the auditors' report. The following analysis provides a high-level summary of MCC's Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position and Statement of Budgetary Resources.

Balance Sheet

Assets

As of September 30, 2014, MCC reported total assets of $4.5 billion, a decrease of approximately 5 percent from FY 2013's total assets of $4.8 billion. MCC's Fund Balance with Treasury (FBwT) constitutes the vast majority (98 percent) of total assets. FBwT decreased $185 million due to outlays exceeding appropriations. Appropriations Received in FY 2014 increased due to the FY 2013 sequester and across-the-board rescission. Gross Outlays exceeded appropriations primarily because of the large number of compacts that have progressed from the startup phase and are in full execution, nearing completion or completed.

Other assets, which total only 2 percent of MCC total assets, include Advances; Property, Plant, and Equipment (PP&E); and Accounts Receivable. Advances (Public) decreased by $47 million primarily due to compact closures in September FY 2013 (Lesotho, Morocco, Mongolia, Mozambique and Tanzania) and countries in anticipation of compact closures in FY 2014 (Burkina Faso and Namibia). Advances (Intragovernmental) increased by $2.3 million due primarily to a $2.9 million Honduras II special advance agreement established between MCC and the Department of the Treasury (Office of Technical Assistance) in September 2014.

MCC has very few capital assets in relation to total assets because it does not own its facilities or other real property and does not have capital leases. MCC has established its capitalization thresholds at $200 thousand for IT equipment and $50 thousand for other fixed assets. As of September 30, 2014, MCC reported fixed assets of approximately $880 thousand, which were mainly leasehold improvements for enhancements made to leased office space at MCC headquarters in Washington, DC. This amount decreased $1.2 million from FY 2013 primarily due to amortization of leasehold improvements.

Accounts receivable decreased from $814 thousand to $1 thousand primarily due to a decrease in compact receivables. During FY 2014, MCC determined that the questioned costs recorded based on OIG compact audits were allowable, which reduced the associated compact receivables. MCC had no outstanding debts connected to nations with compacts or threshold programs.

Liabilities

As of September 30, 2014, MCC had $155 million in liabilities, which represented amounts owed to its grantees, vendors, contractors, trading partners and employees. Total liabilities decreased by 31 percent from FY 2013's total of $223 million. Grant liabilities comprised $143 million, or nearly 92 percent, of MCC's total liabilities. Grant liabilities decreased by $66 million primarily due to compact closures in September 2013 (Lesotho, Mongolia, Morocco, Mozambique and Tanzania). The compact closures in FY 2013 were offset by compacts that have increased their spending authority in anticipation of compact closure (Burkina Faso, Namibia, Senegal, and Moldova). Additionally, MCC recorded contract retentions of $23 million in FY 2014.

Net Position

MCC's overall net position as of September 30, 2014, was $4.4 billion, a decrease of $163 million or 4 percent from FY 2013. The available appropriations reported in MCC's positive net position represent the resources necessary to fund future compacts and demonstrate the lag between appropriation, commitment and expenditure of compact funds.

Statement of Net Cost

This statement shows MCC's net cost of operations, as a whole, by the major programs or appropriation fund categories. During FY 2014, MCC incurred $1.1 billion in net program costs, divided among the seven programs as described in the following tables. Net program costs decreased by $619 million, or 37 percent, from FY 2013. With the exception of Administrative Costs, which increased slightly in FY 2014, costs for the other funds decreased. The first table describes the programs; the second table shows the programs, dollar amounts, percentage changes and the reasons for the changes.

MCC Appropriation Fund Categories

Category	Source/Purpose
Compact[1]	Funds approved by Congress, apportioned by OMB, and obligated by MCC to cover compacts between MCC and partner countries. Under authority contained in section 609(g) of the MCC Act, MCC provides Compact Implementation Funds (CIFs) when it signs a compact to speed compact implementation by the partner country. OMB apportions grant funds for grants and cooperative agreements.
609(g) *(section of the MCC Act)*	Funds approved by Congress and apportioned by OMB to fund contracts or grants for facilitating the development and/or implementation of a compact between MCC and a partner country.

MCC Appropriation Fund Categories

Category	Source/Purpose
614(g) *(section of the MCC Act)*	Funds approved by Congress that the CEO may use to contract with any nongovernmental organization (including a university, independent foundation or other organization) in the United States or in a candidate country and, where appropriate, directly with a governmental agency of any such country that is undertaking research aimed at improving data related to eligibility criteria under this title with respect to the country.
Threshold	MCC funds to help countries to become eligible for MCC compact assistance.
Due Diligence	Funds apportioned by OMB and used by MCC to cover costs associated with assessing compact proposals developed by eligible countries and providing compact implementation oversight.
Audit	Funds appropriated by Congress and apportioned by OMB for audits of MCC operations and programs. The USAID OIG is responsible for conducting MCC audits.
Administrative	Funds appropriated by Congress and apportioned by OMB for operating expenses.

[1]*Includes MCC's CIF.*

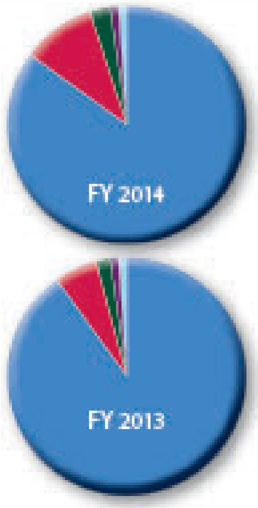
MCC Net Program Costs (Dollars in Thousands)

Program	FY 2014	FY 2013	% Change	Reason for Change
Compact[2]	$ 906,028	$ 1,521,124	–40%	The $615 million decrease was due primarily to compact closures in September 2013 (Lesotho, Morocco, Mongolia, Mozambique, and Tanzania) and anticipation of compact closures in FY 2014 (Burkina Faso and Namibia) and Senegal and Moldova in FY 2015. Additionally, MCC recorded contract retentions of $23 million in FY 2014.
609(g)	12,084	16,633	–27%	The $4.5 million net decrease was primarily the result of a change in accrual methodology in FY 2013. Additionally, there was a downward trend of expenses for existing 609(g) programs in anticipation of 609(g) program closures in FY 2014.
614(g)	—	1	–100%	The $1 thousand decrease was the result of changes in research contracts for improving data related to compact eligibility criteria.

MCC Net Program Costs (Dollars in Thousands)				
Program	FY 2014	FY 2013	% Change	Reason for Change
Threshold	4,520	9,677	–53%	The $5.2 million decrease was primarily the result of decreases in expenses for the USAID threshold because USAID is phasing out the threshold program as well as a reduction of expenses for Saõ Tome & Principe, which completed its program in FY 2013. Additionally, there was a $658 thousand increase in expenses for the Honduras II special advance agreement established between MCC and the Department of the Treasury (Office of Technical Assistance) in September 2014.
Due Diligence	34,580	35,525	–3%	The $945 thousand decrease was due primarily to a decrease in program costs for interagency agreements and consultants, offset by an increase in program costs for IT contracted services and personal service contractors and detailees.
Audit	3,264	3,730	–13%	The $466 thousand decrease was due primarily to a decrease in audit expense accruals and audit operation costs, offset by increases in expense accrual reversals.
Administrative	103,442	96,561	7%	The $6.9 million increase was due primarily to increases in operating expenses/program costs for IT contracted services and International Cooperative Administrative Support Services expenses, offset by decreases in expenses for personal service contractors and detailees.
TOTAL	**$ 1,063,918**	**$ 1,683,251**	**–37%**	

[2]*Includes MCC's CIF.*

As the following chart shows, compact activities are the largest MCC program cost. In FY 2014, compact activities accounted for 85 percent of MCC's expenditures; in FY 2013, compact activities accounted for 90 percent of MCC's expenditures. Administrative and audit program costs rose from 6 percent in FY 2013 to 10 percent of MCC's FY 2014 costs, while due diligence costs rose from 2 to 3 percent. The remaining categories combined (609(g), 614(g) and threshold programs) were less than 2 percent each year.



Net Program Costs

	FY 2014	FY 2013
Compact	85%	90%
Administrative and Audit	10%	6%
Due Diligence	3%	2%
609(g) and 614(g)	1%	1%
Threshold	1%	1%

Statement of Changes in Net Position

This statement shows the change in net position during the reporting period. MCC's net position on September 30, 2014, was $4.4 billion, a decrease of $163 million from $4.5 billion on September 30, 2013. Net position is affected by changes to its two components: Cumulative Results of Operations and Unexpended Appropriations. As of September 30, 2014, Cumulative Results of Operations amounted to $876 thousand, a decrease of $2.3 million, or 72 percent, from $3.2 million on September 30, 2013. This balance is the cumulative difference, for all previous fiscal years, between funds available to MCC from all financing sources and the net costs of MCC. The second component of net position, Total Unexpended Appropriations, amounted to $4.4 billion, a decrease of $161 million, or 4 percent, from FY 2013. This decrease was the result of a decrease in Appropriations Used in FY 2014 of $614 million, which was driven primarily by compact activity.

Statement of Budgetary Resources

This statement and related disclosures provide information about how budgetary resources were made available to MCC, as well as their status at the end of the period. It is the only financial statement derived predominantly from an entity's budgetary general ledger in accordance with budgetary accounting rules. The Statement of Budgetary Resources reflects the format prescribed by OMB Circular No. A-136, *Financial Reporting Requirements.* The total amount displayed for the status of budgetary resources equals the total budgetary resources available to MCC as of September 30, 2014.

For 2014, MCC had total budgetary resources of $2.5 billion, a decrease of $134 million, or 5 percent, from FY 2013. A total of $898 million of budgetary resources were provided through FY 2014 Congressional appropriation and $1.5 billion were carried forward from appropriations in prior years.

An aerial photograph shows construction of new wastewater digesters at the As Samra Treatment Plant in Zarqa, Jordan.

Millennium Challenge Corporation: Jordan

November 28, 2013

Photo by Jake Lyell for MCC

Analysis of MCC's Systems, Controls and Legal Compliance

Systems

MCC does not operate its own financial systems and utilizes the Department of the Interior's Interior Business Center (IBC) as its financial management services provider for financial and payroll systems. MCC is responsible for overseeing IBC and ensuring that financial systems and internal controls are in place to fulfill legislated and regulatory financial management requirements.

Controls

The MCC CEO's annual Assurance Statement and the annual Assurance Statement of Management Controls over Financial Reporting submitted by IBC follow this section.

Internally, at least annually, MCC assesses the vulnerability of its programs and systems in alignment with the Federal Managers' Financial Integrity Act (FMFIA) and its implementing guidance, OMB Circular No. A-123, *Management's Responsibility for Internal Control,* as well as the associated guidelines issued by the CFO Council. OMB Circular No. A-123, Appendix A, "Internal Control over Financial Reporting," provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting and reporting on internal control over financial reporting. Appendix A allows for modified implementation to fit the circumstances, conditions and structure of each entity. As such, through MCC's commitment to prudent financial management and internal controls, during FY 2014 MCC continued its efforts to reassess, improve and enhance its financial, systems, program and performance information.

The information presented in this report meets the objectives of Circular No. A-123 and Appendix A, and is fundamentally complete and reliable as required by OMB. The annual assurance statement required by FMFIA concludes that MCC can provide unqualified assurance that its overall internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations was operating effectively and can provide unqualified assurance that its internal control over financial reporting was operating effectively.

Millennium
Challenge Corporation
United States of America

FY 2014 Assurance Statement from CEO

November 12, 2014

The Millennium Challenge Corporation's (MCC's) management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). MCC conducted an assessment of the effectiveness of internal control in achieving effective and efficient operations and compliance with applicable laws and regulations in accordance with Office of Management and Budget (OMB) Circular Number A-123, *Management's Responsibility for Internal Control.*

Reporting Pursuant to FMFIA Section 2

- **Overall Statement of Assurance**
  Based on the results of its evaluation, MCC can provide unqualified reasonable assurance that its overall internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of June 30, 2014 was operating effectively.
- **Statement of Assurance for Internal Control Over Financial Reporting**
  The independent auditors' report identified a material weakness over MCC's financial reporting. MCC was aware of this system level control weakness and implemented improvements in its internal control over financial reporting to mitigate the material weakness, and satisfactorily tested the effectiveness to determine that the design and operation of the internal controls over financial reporting were effective. As a result, MCC can provide unqualified assurance that its internal control over financial reporting as of June 30, 2014, was operating effectively.

Reporting Pursuant to FMFIA Section 4

The vulnerability of MCC programs and systems was assessed in accordance with FMFIA and OMB guidance. Our assessment identified a material weakness over MCC's financial management systems. MCC uses a Federal Shared Service Provider to process its accounting transactions. MCC was aware of these system level control weaknesses and implemented improvements in controls over its financial management systems to mitigate these weaknesses. As a result, MCC's financial management systems are in substantial conformance with the Section 4 (Financial Systems) requirements of FMFIA as of June 30, 2014.

/ s /

Dana J. Hyde
Chief Executive Officer

United States Department of the Interior
Office of the Secretary

Interior Business Center

October 1, 2014

Dear Oracle Federal Financial Customer:

The purpose of this letter is to provide assurance that the Oracle Federal financial application controls remained unchanged for the period July 1, 2014, through September 30, 2014.

You were previously notified that KPMG LLP examined the description of the Oracle financial application controls at the Department of the Interior (Department), Interior Business Center (IBC). The results of their review and analysis were provided in a Service Organization Control Report (SSAE16) covering the period July 1, 2013, through June 30, 2014. A copy of the report was provided to you under separate cover.

The SSAE 16 review was conducted for the purpose of expressing an opinion as to whether (1) IBC's description of the Oracle application controls presents fairly in all material respects the aspects of the IBC controls that may be relevant to a user organization's internal control; (2) the controls included in the description were suitably designed to achieve the control objectives specified in the description if those controls were complied with satisfactorily; and (3) such controls had been placed in operation as of June 30, 2014. KPMG also performed testing procedures designed to determine the effectiveness of the specified controls in meeting control objectives specified by the IBC.

This letter provides representations and assurances related to Oracle financial application controls at the IBC for the period July 1, 2014, through September 30, 2014. This time period was not covered by the SSAE 16 examination report previously provided. To the best of our knowledge and belief, there have been no subsequent events that would have a significant effect on user organizations that have not been disclosed to you. The controls that have been placed in operation as of June 30, 2014, did not change for the period of July 1, 2014, through September 30, 2014. The description of controls in the FY 2014 SSAE 16 examination report presents fairly the aspects of IBC controls that were in place as of September 30, 2014.

FY 2014 Assurance Statement from Service Provider

MCC's service provider issued the following Statement of Assurance.

United States Department of the Interior
Office of the Secretary

Interior Business Center

The IBC also conducted an assessment of the effectiveness of internal control over financial reporting for customers where the IBC processes your financial transactions, which includes safeguarding of assets and compliance with applicable laws and regulations in accordance with the requirements of Appendix A of OMB Circular A-123 and the CFO Council's Implementation Guide dated July 31, 2005, as implemented by the Department. The assessment focused on the specific IBC financial business processes such as financial reporting, revenue management, funds management, and procurement in place as of June 30, 2014. As of that date, the IBC noted no material or significant deficiencies verified through A-123 Appendix A financial transaction testing. Thus, the IBC asserted internal controls over financial reporting were suitably designed and operating effectively. The procedures and management controls for processing financial transactions have not changed since June 30, 2014. As a result, the IBC continues to assert substantial compliance with financial accounting and reporting controls in place from July 1, 2014, through September 30, 2014.

If you have any questions on this assurance statement, please contact Dean N. Martin, Interior Business Center Audit Liaison, on 303-969-5195.

Sincerely,

James W. Beall, CPA
Chief Financial Officer, Interior Business Center

Summary of Material Weaknesses, Non-Compliance and Corrective Actions

The Independent Auditors' Report identified one material weakness in internal control related to ineffective and inefficient integration of data, processes, and controls within the financial management systems. This was a modified repeat finding from FY 2013.

The report also identified one significant internal control deficiency related to the need to strengthen MCC's validation control over grant accrual estimates. This was a modified repeat finding from FY 2013.

MCC will continue to enhance its internal controls to address the noted material weakness and significant deficiency. During FY 2015, MCC will:

- Correct underlying causes for systematic data entry errors and document limitations within the financial management system.
- Develop comprehensive training guidance for the grant accrual process.
- Continue to improve upon grant accrual and validation review processes and procedures.

Legal Compliance

MCC complies with all applicable Federal statutes and regulations. Key legal requirements include:

Prompt Payment Final Rule

The Prompt Payment Final Rule (Code of Federal Regulations Title 5, Part 1315) requires Federal agencies to pay commercial obligations within certain periods and to pay interest penalties when payments are late. With certain exceptions, payments to vendors are due within 30 days of the later of (1) receipt of properly prepared invoices or (2) the receipt of goods or services. For amounts owed and not paid within the specified payment period, agencies are required to pay interest on the amount owed at a rate established by the Department of the Treasury. MCC measures the percentage of all payments made within the specified timeframes out of all payments subject to the Prompt Payment Final Rule. In FY 2014, MCC's prompt payment performance was 98 percent. MCC is taking steps to reduce the likelihood of future unnecessary interest payments.

Debt Collection Improvement Act of 1996

The Debt Collection Improvement Act requires all Federal agencies to refer for collection to the Department of the Treasury's Bureau of the Fiscal Service past due, legally enforceable, non-tax debts that are more than 180 days delinquent. During FY 2014, MCC did not refer any debt to the Department of the Treasury.

Improper Payments Information Act (as amended by Improper Payments Elimination and Recovery Act of 2010)

The Other Information section of this report contains MCC's Improper Payments Information Act report. The risk assessment results did not identify any funds that met the OMB threshold of significant erroneous payments. Although MCC did not meet the OMB threshold, MCC tested five of its funds to determine if it could identify any significant improper payments. MCC did not identify any improper payments from the sample of disbursements tested.

MCC determined its programs were not susceptible to significant erroneous payments, so it did not include payment recapture audits in the scope of the FY 2014 review.

Federal Information Security Management Act (FISMA) of 2002

In FY 2014, MCC implemented significant improvements to its FISMA program across the compliance and vulnerability management domains. For compliance, MCC implemented changes to its assessment and authorization program and revised the computer security training program for all employees and contractors. MCC also revised the vulnerability management program through the implementation of new technical solutions and revisions of procedures designed to more accurately identify and remediate vulnerabilities. These combined changes culminated in significant reductions to MCC's audit recommendations from the OIG. MCC continues to participate in the Department of Homeland Security's Continuous Diagnostic Monitoring (CDM) program. MCC will install and utilize CDM- procured products

MCC-funded community-driven development projects in the Philippines are helping people in poor villages lift themselves out of poverty through a process that involves them in the selection, design and implementation of small-scale infrastructure projects. These projects are providing greater access to markets and basic education and health facilities.

in the next fiscal year. MCC will initiate a revised computer security training program utilizing the Department of State's Center of Excellence training program for FY 2015.

Privacy Act of 1974

In 2014, MCC revised its privacy training program content, delivery system and compliance tracking. The program included privacy training for all MCC employees and contractors. In addition, MCC implemented a data loss protection program on MCC's cloud email system. In 2015, MCC will continue to improve on the privacy training by implementing the Department of State's Center of Excellence training platform.

Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with generally accepted accounting principles (GAAP) for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Financial Section

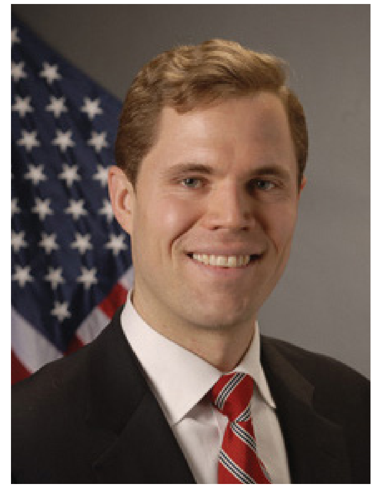
Students attend an MCC-funded vocational training course in Agadir, Morocco. Vocational training programs like these are empowering young adults across Morocco with marketable and sought-after skills.

Millennium Challenge Corporation: Morocco

May 6, 2013

Photo by Jake Lyell for MCC

November 12, 2014



Message from the Vice President, Department of Administration and Finance and Chief Financial Officer

Millennium Challenge Corporation (MCC) invests in some of the world's poorest countries alongside the private sector and governments who show a commitment to good governance, investing in people, and economic freedom. MCC is funding not only large-scale infrastructure projects in transportation and power, but also programs in social sectors, when needed improvements in basic services like health and education can clearly unlock economic activity and growth. At the forefront of all we do is a strong commitment to rigorous management and oversight of the funds with which we have been entrusted. This commitment has been evident throughout the development and implementation of 29 compacts and 24 threshold programs in countries worldwide—including the most recent compacts signed with Ghana and El Salvador in fiscal year 2014, a year in which we celebrate the 10th Anniversary of our founding.

Key to MCC's success is our accountability to U.S. taxpayers for results, our transparency in reporting those results, and our sense of responsibility to reduce poverty around the world.

This Agency Financial Report captures how MCC has used the funds entrusted to us by the President and U.S. Congress to deliver meaningful programs and achieve measurable, sustainable results. Through a rigorous year-round process of evaluation and continuous improvement supported by personnel at MCC headquarters and in our field missions, this report details the financial outcomes from fiscal year 2014.

With our commitment to transparency, visitors to MCC's public website, www.mcc.gov, can access data that show economic rate of return calculations, performance indicator tracking tables and impact evaluation summaries for MCC-funded projects. Our efforts to improve transparency in reporting financial assistance to countries were recognized by *Publish What You Fund's 2014 Aid Transparency Index* in which MCC achieved the highest ranking of any U.S. aid agency and a third-place ranking among 68 organizations worldwide.

I am pleased that MCC's independent auditor expressed an unmodified or clean opinion on our financial statements for a fourth consecutive year. While MCC proudly notes this accomplishment, we remain committed to ongoing improvements, particularly as we look to the next decade. We will use the recommendations provided by our independent auditor as an opportunity to further our quest for excellence in financial management.

/ s /

Matthew L. Bohn
Vice President, Department of Administration and Finance
and Chief Financial Officer

Financial Statements and Notes and Independent Auditors' Report

Financial Section

The principal financial statements have been prepared to report the financial position and the results of operations of the MCC. The financial statements have been prepared from MCC's books and records in accordance with formats prescribed in OMB Circular No. A-136, *Financial Reporting Requirements* (revised on September 18, 2014). The financial 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 2014 and FY 2013 have been included. MCC is presenting the following financial statements and additional information:

- Balance Sheet
- Statement of Net Cost
- Statement of Changes in Net Position
- Statement of Budgetary Resources
- Notes to the Financial Statements
- Independent Auditors' Report

Note that totals may vary slightly due to rounding.

Balance Sheet

As of September 30, 2014 and September 30, 2013 (in thousands)		
Assets	**FY 2014**	**FY 2013**
Intragovernmental:		
Fund Balance with Treasury *(Note 2)*	$ 4,426,412	$ 4,611,354
Advances *(Note 3)*	2,308	38
Total Intragovernmental	**4,428,720**	**4,611,392**
Accounts Receivable, Net *(Note 4)*	1	814
General Property, Plant, and Equipment, Net *(Note 5)*	880	2,124
Advances *(Note 3)*	92,063	138,669
Total Assets	**$ 4,521,664**	**$ 4,752,999**
Liabilities		
Intragovernmental:		
Accounts Payable *(Note 1L)*	$ 320	$ 442
Other Liabilities	236	889
Total Intragovernmental	**556**	**1,331**
Accounts Payable *(Note 1L)*	6,482	6,436
Federal Employee and Veteran Benefits	—	15
Other Liabilities:		
Accrual — Grant Liabilities (Note 7)	142,846	209,259
Accrued Funded Liabilities	5,127	6,433
Total Liabilities	**155,011**	**223,474**
Net Position		
Unexpended Appropriations — All Other Funds	4,365,777	4,526,375
Cumulative Results of Operations — All Other Funds	876	3,150
Total Net Position	**4,366,653**	**4,529,525**
Total Liabilities and Net Position	**$ 4,521,664**	**$ 4,752,999**

The accompanying notes are an integral part of these statements.

Statement of Net Cost

For the Years Ended September 30, 2014 and September 30, 2013 (in thousands)		
Program Costs *(Note 9)*	**FY 2014**	**FY 2013**
Compact Program Costs	$ 906,028	$ 1,521,124
609 (g) Program Costs	12,084	16,633
614 (g) Program Costs	—	1
Threshold Program Costs	4,520	9,677
Due Diligence Program Costs	34,580	35,525
Audit Costs	3,264	3,730
Administrative Costs	103,442	96,561
Net Cost of Operations	**$ 1,063,918**	**$ 1,683,251**

The accompanying notes are an integral part of these statements.

Statement of Changes in Net Position

For the Years Ended September 30, 2014 and September 30, 2013 (in thousands)	FY 2014	FY 2013
Cumulative Results of Operations:		
Beginning Balances	$ 3,150	$ 11,069
Budgetary Financing Sources:		
Appropriations Used	1,058,798	1,672,986
Other Financing Sources:		
Donations and Forfeitures of Property *(Note 8)*	546	320
Imputed Financing	2,300	2,026
Total Financing Sources	**1,061,644**	**1,675,332**
Net Cost of Operations	**(1,063,918)**	**(1,683,251)**
Net Change	**(2,274)**	**(7,919)**
Cumulative Results of Operations	**876**	**3,150**
Unexpended Appropriations:		
Beginning Balance	4,526,375	5,346,633
Budgetary Financing Sources:		
Appropriations Received	898,200	898,200
Other Adjustments	—	(45,472)
Appropriations Used	(1,058,798)	(1,672,986)
Total Budgetary Financing Sources	**(160,598)**	**(820,258)**
Total Unexpended Appropriations	**4,365,777**	**4,526,375**
Net Position	**$ 4,366,653**	**$ 4,529,525**

The accompanying notes are an integral part of these statements.

Statement of Budgetary Resources

For the Years Ended September 30, 2014 and September 30, 2013 (in thousands)	FY 2014	FY 2013
Budgetary Resources:		
Unobligated Balance Brought Forward, October 1	$ 1,505,408	$ 1,760,688
Recoveries of Prior Year Unpaid Obligations	133,763	57,623
Unobligated balance from Prior Year Budget Authority, Net	1,639,171	1,818,311
Appropriations *(Note 1E)*	898,200	852,728
Total Budgetary Resources	**$ 2,537,371**	**$ 2,671,039**
Status of Budgetary Resources:		
Obligations Incurred	$ 697,910	$ 1,165,631
Unobligated Balance, End of Year:		
Apportioned	1,705,250	1,454,851
Unapportioned	134,211	50,557
Total Unobligated Balance, End of Year	1,839,461	1,505,408
Total Budgetary Resources	**$ 2,537,371**	**$ 2,671,039**
Change in Obligated Balance:		
Unpaid obligations:		
Unpaid Obligations, Brought Forward, October 1	$ 3,105,685	$ 3,559,785
Obligations Incurred	697,910	1,165,631
Outlays (Gross)	(1,082,883)	(1,562,108)
Recoveries of Prior Year Unpaid Obligations	(133,763)	(57,623)
Unpaid Obligations, End of Year	**$ 2,586,949**	**$ 3,105,685**
Memorandum entries:		
Obligated Balance, Start of Year	**$ 3,105,685**	**$ 3,559,785**
Obligated Balance, End of Year	**$ 2,586,949**	**$ 3,105,685**
Budget Authority and Outlays, Net:		
Budget Authority, Gross	$ 898,200	$ 852,728
Budget Authority, Net (total)	**$ 898,200**	**$ 852,728**
Outlays, Gross	$ 1,082,883	$ 1,562,108
Outlays, Net (total)	**$ 1,082,883**	**$ 1,562,108**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

As of September 30, 2014 and September 30, 2013

Note 1 — Summary of Significant Accounting Policies

A. Reporting Entity

The Millennium Challenge Act of 2003, as amended, contained in Title VI, Division D of Public Law 108-199 (the Consolidated Appropriations Act of 2004) established MCC as a wholly-owned Government corporation, as defined by the Government Corporation Control Act. MCC's mission is to reduce poverty through grants by supporting sustainable, transformative economic growth in developing countries that maintain sound policy environments.

B. Reporting by Operational Components

MCC reports the results of its operations, as a whole, by its major programs or appropriation fund categories, which consist of the following:

- **Compact** — Compact funds comprise large, 5-year grants for countries meeting MCC's eligibility criteria.
- **609(g) of the Millennium Challenge Act of 2003** — 609(g) funds cover contracts or grants that facilitate the development of a compact between MCC and a partner country.
- **614(g) of the Millennium Challenge Act of 2003** — 614(g) funds comprise research contracts to improve data related to eligibility criteria. The contracts may be with a university, independent foundation, government entity, or other organization in the United States or a candidate country where such entity or country is undertaking research to improve data related to eligibility criteria under this title.
- **Threshold** — Threshold programs are smaller grants awarded to countries that come close to meeting the eligibility criteria for compacts.
- **Due Diligence** — Due Diligence funds support the cost of assessing compact proposals and providing compact implementation oversight.
- **Audit** — Audit funds cover audits of MCC operations and programs. The U.S. Agency for International Development (USAID) Office of Inspector General (OIG) performs and manages MCC programmatic and financial audits.
- **Administrative** — Administrative funds cover MCC's operating expenses.

C. Basis of Accounting and Presentation

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America and accounting standards issued by the Federal Accounting Standards Advisory Board (FASAB) in the format prescribed by the OMB Circular No. A-136, *Financial Reporting Requirements* (revised on September 18, 2014). FASAB is recognized by the American Institute of Certified Public Accountants as the official accounting standards-setting body for United States Government entities. The financial statements present the financial position, net cost of operations, changes in net position, and budgetary resources of MCC, as required by the Chief Financial Officers (CFO) Act of 1990, the Government Management Reform Act of 1994, and the Government Corporation Control Act (31 United States Code [U.S.C.] §9106).

The accounting structure of Federal activities is designed to reflect both the accrual and budgetary basis of accounting. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. The accompanying Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position are prepared using the accrual method of accounting. The Statement of Net Cost reports MCC's gross cost less earned revenues to arrive at net cost of operations. MCC has no earned revenue. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds. Budgetary accounting principles are designed to recognize the obligation of funds according to legal requirements, which may be prior to the occurrence of an accrual-based transaction. The Statement of Budgetary Resources is prepared in accordance with budgetary accounting rules.

While the financial statements have been prepared from the books and records of MCC in accordance with the formats prescribed by OMB, these financial statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. Intradepartmental transactions and balances have been eliminated from the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position.

MCC's financial statements should be read with the realization that they are for a component of the Federal Government, a sovereign entity, whose liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the Federal Government acting in its capacity as a sovereign entity.

D. Use of Estimates in Preparing Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions, and exercise judgment that affects the reported amounts of assets, liabilities, net position, and disclosure of contingent liabilities as of the date of the financial statements, as well as the reported amounts of financing sources, expenses, and obligations incurred during the reporting period. These estimates are based on management's best knowledge of current events, historical experience, actions MCC may take in the future, and on various other assumptions that are believed to be reasonable under the circumstances. The Notes to the Financial Statements include information to assist the reader in understanding the effect of changes in assumptions on the related information.

E. Budgetary Basis of Accounting

MCC's programs and activities are funded 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. These 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.

F. Grant Liabilities Accrual Methodology

MCC approves spending authority for a country-specific accountable entity (Millennium Challenge Account, or MCA) on a quarterly basis. In reviewing the grant accrual methodology, it was determined that "unused spending authority" is the upper limit of the accrual. It was also determined that the "MCA In-house Invoices" is the lower limit of the accrual. Within these upper and lower limits, MCC is discounting unused spending authority by using a rolling average of actual disbursements to calculate the grant liabilities accrual. Contract retentions represent a percentage of invoice amounts retained by the MCA for contract work completed. The MCA does not request MCC grant funds for amounts that have been retained until the MCA has verified compliance by the contractor of their obligations under the contract. MCC is not a party to any contracts between the MCAs and their contractors and therefore, is not liable for disputed claims between the two entities. Retentions are determined by the MCAs, as they are independent and separate entities from MCC. Retentions are required by MCC under its Program Procurement Guidelines that the MCAs are required to follow. However, MCC recognizes MCA contract retentions as part of the Grant Accrual Liability.

G. Fund Balance with Treasury

Fund Balance with Treasury (FBWT) represents the aggregate amount of MCC's accounts with Treasury available to pay current and future liabilities and finance authorized purchases, except where prohibited by law. Treasury processes all cash receipts and disbursements on behalf of MCC. MCC's fund balances with Treasury represent no-year funds maintained in appropriated accounts. MCC's records are reconciled with those of Treasury on a monthly basis.

H. Advances

MCC advances funds through a country-specific MCA. In agreement with the country government, an accountable entity is created to receive and administer the grants. MCC tracks the MCA's progress on a monthly basis. MCC receives a periodic reporting of advances from MCAs through monthly reporting of actual operating advances via the Monthly Commitments and Disbursements Report. Based on these reports, MCC adjusts advance and expense balances accordingly.

I. Accounts Receivable, Net

Accounts receivable reflect overpayments of payroll, travel, and other MCC current and former employee expenses. Accounts receivable also reflect substantiated disallowed MCA expenditures. Receivables that exist with foreign countries are considered sovereign debt. Public accounts receivable are presented net of an allowance for doubtful accounts, which is based on analyses of debtors' ability to pay, specific identification of probable losses, aging analyses of past-due receivables, or historical collection experience.

J. General Property, Plant, and Equipment, Net

MCC's general property, plant, and equipment (PP&E) consists of capitalized general equipment costs. MCC's capitalization threshold is $50,000 for all assets, except for information technology (IT) equipment, for which the capitalization threshold is $200,000. The basis for recording purchased PP&E is the full cost of the acquired asset, including all costs required to bring the asset to the form and location suitable for its intended use.

Leasehold improvements are depreciated using the straight-line method of depreciation over the estimated useful lives of improvement (usually between 8 and 10 years), depending on the years in the lease agreement. All other general PP&E is depreciated using the straight-line method over an estimated useful life of 5 years.

K. Liabilities

Liabilities represent the probable and measurable future outflow or other use of resources as a result of past transactions or events. Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or for which funding is otherwise available to pay amounts due. Liabilities not covered by budgetary or other resources represent amounts owed in excess of available Congressionally-appropriated funds or other amounts, where there is no certainty that the appropriations will be enacted.

L. Accounts Payable

Accounts payable represent amounts due to Federal and non-Federal entities for goods and services received by MCC that have not been paid at the end of the accounting period. Intragovernmental Accounts Payable represents payable transactions with other Federal Government agencies (e.g., USAID, U.S. Department of the Interior, etc.), while non-Federal Accounts Payable represents transactions with non-Federal entities.

M. Other Liabilities — Intragovernmental

Accrued Payroll

Accrued payroll consists of salaries, wages, and other compensation earned by the employees but not disbursed as of September 30, 2014. The liability is estimated for reporting purposes based on historical pay information.

Employee Retirement Benefits

MCC's employees participate in either the Federal Employees Retirement System (FERS) or the Civil Service Retirement System (CSRS). 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. FERS consists of Social Security, a gross annuity plan, and a Federal Thrift Savings Plan (TSP). MCC and the employee contribute to Social Security and the gross annuity plan at rates prescribed by law. In addition, each year MCC is required to contribute to the Federal TSP a minimum of 1 percent of the gross pay of employees covered by this system, match voluntary employee contributions up to 3 percent of the employees' gross pay, and match one-half of contributions between 3 and 5 percent of the employees' gross pay, for a maximum MCC contribution of 5 percent of pay. For FERS employees, MCC also contributes the employer's share of Medicare.

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 7 percent of their gross pay toward their retirement benefits. A matching contribution of 7 percent is required and is automatically deducted from the employees' gross pay. Employees under CSRS may participate in the TSP, but will not receive MCC's automatic or matching contributions.

Federal employee benefit costs paid by the U.S. Office of Personnel Management (OPM) and imputed by MCC are reported on the Statement of Net Cost. Contributions for FERS, CSRS, and other retirement benefits are insufficient to fund the programs fully and are subsidized by OPM. MCC imputes its share of the OPM subsidy, using cost factors provided by OPM, and reports the full cost of the programs related to its employees.

N. Federal Employee and Veteran Benefits

Federal Employee and Veteran Benefits consist of salaries, wages, leave, and benefits earned by employees but not disbursed at the end of the reporting period.

Actuarial Federal Employees Compensation Act

The Federal Employees Compensation Act (FECA) (established by Public Law 103-3) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred work-related occupational diseases, 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 not funded by current appropriations.

O. Other Liabilities — Public

Accrued Annual Leave

A liability for annual and other vested compensatory leave is accrued as earned and reduced when taken. 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.

Custodial Liabilities

Under current policies 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 Treasury's General Fund.

P. 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. Cumulative results of operations represent the net differences between financing sources and expenses since MCC's inception.

Q. 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 for Federal Tort Claims Act settlements or awards pertaining to these litigations are funded from a special appropriation administered by Treasury called the Judgment Fund. Although the ultimate disposition of any potential Judgment Fund proceedings cannot be determined, MCC management expects that any liability or expense that might ensue would not be material to MCC's financial statements.

R. Parent/Child Relationships with Other Federal Agencies

MCC is a party to allocation transfers as a transferring (parent) entity with USAID, which serves as the recipient (child) entity. Allocation transfers are legal delegations by one department of its ability 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 incurred by the child entity are also charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Generally, 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 budget apportionments are derived.

As a result, there are amounts reported in MCC's Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Budgetary Resources for which the activity is performed by USAID acting as the child in this financial relationship.

S. Contingencies

A loss contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to MCC. The uncertainty ultimately should be resolved when one or more future events occur or fail to occur. The likelihood that the future event or events will occur confirms the loss; the incurrence of a liability can range from probable to remote. Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government,* as amended by SFFAS No. 12, *Recognition of Contingent Liabilities from Litigation,* contains the criteria for recognition and disclosure of contingent liabilities.

MCC could be a party to various administrative proceedings, legal actions, and claims brought by or against it. With the exception of pending, threatened, or potential litigation, a contingent liability is recognized when a past transaction or event has occurred, a future outflow or other sacrifice of resources is more likely than not to occur, and the related future outflow or sacrifice of resources is measurable. For pending, threatened, or potential litigation, a contingent liability is recognized when a past transaction or event has occurred, a future outflow or other sacrifice of resources is likely to occur, and the related future outflow or sacrifice of resources is measurable.

T. Intragovernmental Transactions and Relationships

Intragovernmental transactions are transactions in which only Federal entities are parties to the transaction. MCC has intragovernmental relationships with various Federal entities. Transactions with the public are transactions in which one party to the transaction is a Federal entity and the other is a non-Federal entity.

If a Federal entity purchases goods or services from another Federal entity and sells them to the public, the exchange revenue is classified as with the public, but the related costs are classified as intragovernmental. The purpose of the classification is to enable the Federal Government to prepare consolidated financial statements which eliminate intragovernmental transactions.

Note 2 — Fund Balance with Treasury

MCC's FBWT balance is comprised of only General Funds, which primarily consist of no-year appropriated funds.

Fund Balance with Treasury as of September 30, 2014 and September 30, 2013 (in thousands)

Fund Balances	2014	2013
General Funds	$ 4,426,412	$ 4,611,354
Total	**$ 4,426,412**	**$ 4,611,354**

The Status of Fund Balance with Treasury is primarily the total fund balance as recorded in the general ledger for unobligated and obligated balances:

- **Unobligated Balance** – *Available* — The amount remaining in appropriated funds available for obligation in future fiscal years
- **Unobligated Balance** – *Unavailable* — The amount remaining in appropriated funds used only for adjustments to previously recorded obligations
- **Obligated Balance** – *Not Yet Disbursed* — The cumulative amount of obligations incurred for which outlays have not been made
- **Non-Budgetary Fund Balance with Treasury** — Comprised of amounts in General Fund Proprietary Receipts, Proceeds of Sales, Personal Property, and Undistributed Intragovernmental Payment funds.

Status of Fund Balance with Treasury as of September 30, 2014 and September 30, 2013 (in thousands)		
Status of Fund Balance with Treasury	2014	2013
Unobligated Balance		
Available	$ 1,705,250	$ 1,454,851
Unavailable	134,211	50,557
Obligated Balance not yet Disbursed	2,586,949	3,105,684
Non-Budgetary FBWT	2	262
Total	**$ 4,426,412**	**$ 4,611,354**

Note 3 — Advances

As of September 30, 2014, MCC reported intragovernmental advances totaling $2,308 thousand, and public advances totaling $92,063 thousand. As of September 30, 2013, the amounts reported were $38 thousand and $138,669 thousand, respectively. The $46,606 thousand net decrease in public advances is composed primarily of the net effect of Compact closures, the addition of new Compacts, and fluctuations in Advance balances in ongoing Compacts.

Note 4 — Accounts Receivable, Net

Total receivables at September 30, 2014 and September 30, 2013 were $1 thousand and $814 thousand, respectively. The Accounts Receivable balance represents net valid claims by MCC to cash or other assets of other entities. Accounts Receivable Due from the Public is the total of miscellaneous debts due to MCC from employees and/or smaller reimbursements from other non-federal entities. A periodic evaluation of public accounts receivable is performed to estimate any uncollectible amounts based on current status. An allowance for doubtful accounts is recorded, for Accounts Receivable Due from the Public, to bring Accounts Receivable to its Net Realizable Value in accordance with SFFAS No. 1, *Accounting for Selected Assets and Liabilities.*

Note 5 — General Property, Plant, and Equipment, Net

MCC reports depreciation expense using the straight-line method over an asset's estimated useful life, beginning with the month the asset is placed in service. General PP&E is presented net of accumulated depreciation.

Status of General Property, Plant, and Equipment, Net as of September 30, 2014 (in thousands)				
	Estimated Useful Life	Cost	Accumulated Depreciation	Book Value
General PP&E				
Leasehold Improvements	8–10 years	$ 10,924	$ 10,052	$ 872
Other General PP&E	5 years	139	131	8
Total		**$ 11,063**	**$ 10,183**	**$ 880**

Status of General Property, Plant, and Equipment, Net as of September 30, 2013 (in thousands)				
	Estimated Useful Life	Cost	Accumulated Depreciation	Book Value
General PP&E				
Leasehold Improvements	8–10 years	$ 10,924	$ 8,836	$ 2,088
Other General PP&E	5 years	139	103	36
Total		**$ 11,063**	**$ 8,939**	**$ 2,124**

Note 6 — Leases

MCC leases office space in two adjacent locations in Washington, D.C. These operating leases are on 10-year (Bowen Building) and 8-year (City Center Building) lease terms that terminate on May 25 and May 26, 2015, respectively. MCC has signed a new lease for Franklin Court in anticipation of the lease terminations for the Bowen and City Center Buildings. The Franklin Court office space is a 10-year operating lease in which lease payments commence in May, 2015.

MCC also has short-term leases for one corporate vehicle (through September 28, 2015) and 14 copier machines (through September 29, 2017). The future lease payments due are depicted below.

Future Lease Payments Due — Buildings (in thousands)				
	Asset Category			
	Bowen Building	City Center	Franklin Court	Totals
FY 2015	$ 2,349	$ 912	$ 1,864	$ 5,125
FY 2016	—	—	5,269	5,269
FY 2017	—	—	5,382	5,382
FY 2018	—	—	5,498	5,498
FY 2019	—	—	5,617	5,617
After FY 2019	—	—	25,765	25,765
Total Future Lease Payments	**$ 2,349**	**$ 912**	**$ 49,395**	**$ 52,656**

Future Lease Payments Due — Equipment (in thousands)			
	Asset Category		
	Vehicle	Copier	Totals
FY 2015	$ 11	$ 44	$ 55
FY 2016	—	44	44
FY 2017	—	44	44
Total Future Lease Payments	**$ 11**	**$ 132**	**$ 143**

Note 7 — Accrual - Grant Liabilities

In September 30, 2014 and September 30, 2013, MCC had grant liabilities of $142,846 thousand and $209,259 thousand, respectively. The $66,413 thousand decrease in grant liabilities was the result of changes in the compact portfolio in FY 2013 and FY 2014.

Note 8 — Donated Services

On occasion, MCC may utilize donated services from other Federal agencies, individuals, and private firms in the course of its normal business operations. The approximate fair market value of donated services was $546 thousand for FY 2014 and $320 thousand for FY 2013.

Note 9 — Intragovernmental Costs

The below illustrates the value of exchange transactions between MCC and other Federal entities, as well as non-Federal (public) entities. Intragovernmental costs relate to transactions between MCC and other Federal entities. Public costs relate to transactions between MCC and non-Federal entities.

Intragovernmental Costs (in thousands)	2014	2013
Compact Programs		
Intragovernmental	$ 790	$ 7,068
Public	905,238	1,514,056
Total Compact Costs	**906,028**	**1,521,124**
609(g) Programs		
Intragovernmental	1,992	3,875
Public	10,092	12,758
Total 609(g) Costs	**12,084**	**16,633**
614(g) Programs		
Intragovernmental	—	—
Public	—	1
Total 614(g) Costs	**—**	**1**
Threshold Programs		
Intragovernmental	1,338	936
Public	3,182	8,741
Total Threshold Costs	**4,520**	**9,677**
Due Diligence Programs		
Intragovernmental	3,669	4,173
Public	30,911	31,352
Total Due Diligence Costs	**34,580**	**35,525**
Audit Programs		
Intragovernmental	3,024	3,554
Public	240	176
Total Audit Costs	**3,264**	**3,730**
Administrative Programs		
Intragovernmental	27,772	16,857
Public	75,670	79,704
Total Administrative Costs	**103,442**	**96,561**
Total Program Costs	**$ 1,063,918**	**$ 1,683,251**

Note 10 — Undelivered Orders at the End of the Period

Undelivered orders at the end of the period totaled $2,526,304 thousand and $3,021,121 thousand as of September, 2014 and September 30, 2013, respectively.

Undelivered Orders at September 30, 2014 and September 30, 2013 (in thousands)		
Programs	2014	2013
Compact	$ 2,306,353	$ 2,826,652
609(g)	18,090	26,885
614(g)	4	4
Threshold	22,045	25,349
Due Diligence	100,341	90,702
Audit	1,830	1,657
Administrative	77,641	49,872
Total	**$ 2,526,304**	**$ 3,021,121**

Note 11 — Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the U.S. Government

The table below documents the differences between the FY 2013 Statement of Budgetary Resources and the actual amounts reported for FY 2013 in the Budget of the Federal Government. Since the FY 2014 financial statements will be reported prior to the release of the Budget of the Federal Government, MCC is reporting for FY 2013 only. Typically, the Budget of the Federal Government with the FY 2014 actual data is published in February of the subsequent year. Once published, the FY 2014 actual data will be available on www.whitehouse.gov/omb.

Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the U.S. Government (in millions)			
	Budgetary Resources	Obligations Incurred	Net Outlays
Statement of Budgetary Resources	$ 2,671	$ 1,166	$ 1,562
Additions	1	—	1
Budget of the U.S. Government	**$ 2,672**	**$ 1,166**	**$ 1,563**

The $1 million difference for Budgetary Resources and Net Outlays is due to rounding.

Note 12 — Reconciliation of Net Cost of Operations to Budget

SFFAS No.7, *Accounting for Revenues and Other Financing Concepts for Reconciling Budgetary and Financial Accounting,* requires a reconciliation of proprietary and budgetary accounting information. Accrual-based measures used in the Statement of Net Cost differ from the obligation-based measures used in the Statement of

Budgetary Resources. The below note reconciles the net obligations derived from the Statement of Budgetary Resources and net costs of operations derived from the Statement of Net Cost by identifying key items that affect one financial statement but not the other for September 30, 2014, and September 30, 2013, respectively. Total Resources Used to Finance Items Not Part of the Net Cost of Operations at the end of the period totaled $494,866 thousand and $564,978 thousand as of September 30, 2014, and September 30, 2013, respectively, and is comprised of current year Unpaid Obligations, Advances, and Recoveries of Prior Year Obligations.

Reconciliation of Net Cost of Operations to Budget for the Year Ending September 30, 2014 (in thousands)

Resources Used to Finance Activities		FY 2014 Reported Program Costs	
Budgetary Resources Obligated		Gross Costs	
Obligations Incurred	$ 697,910	Net Program Costs	$ 1,063,918
Recoveries of Prior Year Unpaid Obligations	(133,763)		
Other Financing Sources	2,846		
Total Resources Used to Finance Activities	566,993		
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	494,866	Less: Earned Revenue	
Total Components of Net Cost of Operations that will Not Require or Generate Resources	2,059	Net Program Revenue	—
Net Cost of Operations per the Budget	**$ 1,063,918**	**Net Cost of Operations per the Statement of Net Cost**	**$ 1,063,918**

Reconciliation of Net Cost of Operations to Budget for the Year Ending September 30, 2013 (in thousands)

Resources Used to Finance Activities		FY 2013 Reported Program Costs	
Budgetary Resources Obligated		Gross Costs	
Obligations Incurred	$ 1,165,631	Net Program Costs	$ 1,683,251
Recoveries of Prior Year Unpaid Obligations	(57,623)		
Other Financing Sources	2,346		
Total Resources Used to Finance Activities	1,110,354		
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	564,978	Less: Earned Revenue	
Total Components of Net Cost of Operations that will Not Require or Generate Resources	7,919	Net Program Revenue	—
Net Cost of Operations per the Budget	**$ 1,683,251**	**Net Cost of Operations per the Statement of Net Cost**	**$ 1,683,251**

Independent Auditors' Report

OFFICE OF INSPECTOR GENERAL

AUDIT OF THE MILLENNIUM CHALLENGE CORPORATION'S FINANCIAL STATEMENTS, INTERNAL CONTROLS, AND COMPLIANCE FOR THE FISCAL YEARS ENDING SEPTEMBER 30, 2014 AND 2013

AUDIT REPORT NO. M-000-15-001-C
NOVEMBER 14, 2014

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 Inspector General

November 14, 2014

Ms. Dana J. Hyde
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 Fiscal Years Ending September 30, 2014 and 2013 (Report No. M-000-15-001-C)

Dear Ms. Hyde:

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 fiscal years ending September 30, 2014 and 2013. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards, Office of Management and Budget (OMB) Bulletin 14-02, *Audit Requirements for Federal Financial Statements*, and the GAO/PCIE Financial Audit Manual.

The independent auditor expressed an unmodified opinion on MCC's fiscal year (FY) 2014 financial statements. The report states that the financial statements referred to above present fairly, in all material respects, the net position of MCC as of September 30, 2014 and 2013, and its net cost, changes in net position and budgetary resources for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States.

In MCC's FY 2014 financial statements, the auditor identified one issue that was considered a material weakness and one other issue that was considered a significant deficiency. 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.

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

The material weakness was:

- Ineffective and Inefficient Integration of Data, Processes and Controls within the Financial Management Systems (Modified Repeat Finding)

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.

The significant deficiency was:

- Validation Control Over Grant Accrual Estimates Needs to be Strengthened (Modified Repeat Finding)

The auditor did not identify any instance of material non-compliance with laws and regulations.

In carrying out its oversight responsibilities, OIG reviewed the audit report and audit documentation provided by CliftonLarsonAllen LLP. This review, is different from an audit in accordance with U.S. generally accepted government auditing standards and was not intended to enable OIG to express, and we do not express, opinions on MCC's financial statements, internal control, or compliance with laws, regulations, contracts or grant agreements. CliftonLarsonAllen LLP is responsible for the attached auditor's report, dated November 12, 2014, and the conclusions expressed in it. However, our review disclosed no instances in which CliftonLarsonAllen LLP did not comply, in all material respects, with applicable standards.

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

<u>Material Weakness</u>

Ineffective and Inefficient Integration of Data, Processes, and Controls within the Financial Management Systems (Modified Repeat Finding)

Regarding the core financial system, we recommend that MCC:

1. Perform a comprehensive review and determine whether the Shared Service Provider's (SSP) financial management system is meeting its financial management and reporting needs. As part of this review, management should continue to evaluate whether:

    a. a separate grants management system that focuses on program and financial administrations that interfaces with the core financial system is needed, or

    b. to establish alternatives to recording numerous data lines in the Oracle AP and PO modules which is manual intensive and prone to errors.

2. Investigate and correct the underlying causes for the system errors and limitations that prevent or delay the recording, processing, and summarizing of accounting transactions. Key issues that remain unresolved should be escalated immediately rather than back-log the problem. MCC should ensure that errors and open tickets are resolved appropriately and timely by the SSP and that routine MCA accounting activities recorded in Oracle

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within the specified timeline. Moreover, manual adjusting journal entries should be used for limited transactions like unusual one-time entries or correcting entries.

3. In collaboration with the SSP, formalize in writing the system's issues and standardize the resolution processes and policy/procedures.

Regards supervisory reviews, we recommend that MCC:

4. Further review SSP data entries relating to MCA payment processing and related adjustments (i.e. obligation/disbursement adjustments). Perform reconciliation of AP and PO on a monthly basis and proactively resolve all differences in a timely manner.

Significant Deficiency

Validation Control over Grant Accrual Estimates Needs to be Strengthened (Modified Repeat Finding)

We recommend that MCC:

5. Update its *Expense Accruals Financial management Division Procedure Manual* to:

   A. Provide clear guidance regarding the accrual process as it relates to compacts that are in their final year as to how the accrual will be determined;

   B. Address how contract retentions will be accounted for and included in the grant accrual estimate; and

   C. Provide a logical and supportable look-back analysis and validation process to assess the reasonableness of the grant accrual on a quarterly basis. The look-back analysis should provide MCC with sufficient and appropriate 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.

6. Ensure that policies and procedures developed are current and are fully implemented by MCC staff during the grant accrual process to avoid potential calculation errors in the future.

OIG acknowledges MCC's management decisions for all 6 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) 712-5817, if you have any questions concerning this report.

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Sincerely,

/s/

Nathan Lokos
Assistant Inspector General for Audit
Millennium Challenge Corporation

cc: Parita Shah, Chief of Staff
shahp@mcc.gov

Matt Bohn, Vice President of Administration and Finance & Chief Financial Officer
bohnml@mcc.gov

Terry Bowie, Chief Financial Advisor
tlbowie@mcc.gov

Eric Redmond, Deputy Chief Financial Officer
redmondeq@mcc.gov

Karla Chryar, Compliance Officer
Chryarkl@mcc.gov

Kamran Khan, Vice President of Compact Operations
khank@mcc.gov

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MILLENNIUM CHALLENGE CORPORATION

September 30, 2014

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CliftonLarsonAllen

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INDEPENDENT AUDITORS' REPORT

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

To the Board of Directors
Millennium Challenge Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of Millennium Challenge Corporation (MCC), which comprise the balance sheets as of September 30, 2014 and 2013, the related statements of net cost and changes in net position, and the combined statements of budgetary resources for the years then ended, and the related notes to the financial statements (financial statements).

Management's Responsibility for the Financial Statements

MCC management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America (U.S.) and the design, implementation, and maintenance of internal control over financial reporting relevant to the preparation and fair presentation of these financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the U.S.; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 14-02). Those standards and OMB Bulletin 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

We are also responsible for applying certain limited procedures with respect to the required supplementary information and other information included with the financial statements.

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, 2014 and 2013, and its net costs, changes in net position, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the U.S.

Other Matters

Required Supplementary Information
Accounting principles generally accepted in the U.S. issued by the Federal Accounting Standards Advisory Board (FASAB) require that MCC's Management Discussion & Analysis (MD&A) in pages 7 through 33 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by FASAB, 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 MD&A because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information
The other information such as the Message from the Chief Executive Officer in pages 3 and 4, Message from the Vice President, Department of Administration and Finance and Chief Financial Officer in page 37, and other information in pages 85 to 115 contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or RSI. The other information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Report on Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered MCC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we identified certain deficiencies in internal control described below and in Exhibits 1 and 2 that we consider to be a material weakness and a significant deficiency, respectively.

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 MCC's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency summarized below and described in Exhibit 1 to be a material weakness.

<u>Ineffective and Inefficient Integration of Data, Processes and Controls within the Financial Management Systems (Modified Repeat Finding)</u>

A *significant deficiency* is a 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. We consider the deficiency summarized below and described in Exhibit 2 to be a significant deficiency.

<u>Validation Control over Grant Accrual Estimates Needs to be Strengthened (Modified Repeat Finding)</u>

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether MCC's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements consistent with our professional responsibilities discussed below.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported in accordance with the *Government Auditing Standards* or OMB Bulletin 14-02.

Management's Responsibility for Internal Control and Compliance

MCC management is responsible for (1) evaluating the effectiveness of internal control over financial reporting based on criteria established under the Federal Managers' Financial Integrity Act (FMFIA), (2) providing a statement of assurance on the overall effectiveness on internal control over financial reporting, and (3) complying with other applicable laws, regulations, contracts, and grant agreements.

Auditors' Responsibilities

We are responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting to plan the audit, and (2) testing compliance with certain provisions of laws, regulations, contracts and grant agreements that have a direct and material effect on the determination of the financial statement amounts and applicable laws and regulations for which OMB Bulletin 14-02 requires testing.

We did not evaluate all internal controls relevant to operating objectives as broadly established by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. 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, regulations, contracts and grant agreements applicable to MCC. We limited our tests of compliance to certain provisions of laws, regulations, contracts and grant agreements that have a direct and material effect on the determination of the financial statement amounts and applicable laws and regulations for which OMB Bulletin 14-02 requires testing. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

Management's Response to Findings

Management's response to the findings identified in our report is presented in Exhibit 3. We did not audit MCC's response and, accordingly, we express no opinion on it.

Status of Prior Year's Control Deficiencies

We have reviewed the status of MCC's corrective actions with respect to the findings included in the prior year's Independent Auditors' Report, dated December 11, 2013. The status of prior year findings is presented in Exhibit 4.

Purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance and Other Matters

The purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance and Other Matters sections of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of MCC's internal control or on compliance. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MCC's internal control and compliance. Accordingly, these reports are not suitable for any other purpose.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP
Arlington, Virginia
November 12, 2014

EXHIBIT 1

Material Weakness

1. Ineffective and Inefficient Integration of Data, Processes, and Controls within the Financial Management Systems (Modified Repeat Finding)

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 five components of internal control, are the actions management establishes through policies and procedures to achieve the objectives and respond to risks in the internal control system, which includes the entity's information system.

Control activities can be implemented in either an automated or a manual manner. 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. Other control activities include: proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions. Monitoring, which is another component of internal control, assesses the quality of performance over time and promptly resolves the findings of audits or other reviews. Corrective actions are a necessary complement to control activities in order to achieve agency objectives. Ongoing monitoring includes regular management and supervisory activities, comparisons, reconciliations, and other routine actions.

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.

MCC continued to make progress in maintaining internal control to improve its accounting and financial reporting processes. For example, in FY 2014, MCC made improvements in resolving legacy open system tickets on a timelier basis. MCC stated that during the last six months of Fiscal Year (FY) 2014, it closed 52% of all tickets open longer than 6 months and 80% of all open tickets. Also, supervisory reviews have been more effective in identifying balance errors at the financial management system's sub-modules (i.e. AP, PO) level and making necessary correcting entries at the system's general ledger (GL) module in order to report correct financial account balances and accommodate financial reporting processes throughout the fiscal year. However, MCC continues to face a huge challenge in its accounting and reporting processes primarily due to its financial management systems' limitations, and the sheer volume of financial activities that are complex and require manual attentions and reviews to compensate for the systems' limitations. As a result, the accounting and financial reporting processes, as a whole, is inefficient, duplicative, and the risks that internal controls are not effective to prevent, detect, and correct errors timely is high, increasing the reasonable possibility of a material misstatement in the financial statements.

We have summarized and grouped those findings into systemic issues below:

a. *Standards for Internal Control in the Federal Government* states that "Management retains responsibility for monitoring the effectiveness of internal control over the assigned processes performed by service organizations." Service organizations are external parties that management engages to perform certain operational processes for the entity, such as accounting and payroll processing.

1-1

EXHIBIT 1

Material Weakness

MCC uses a Shared Service Provider (SSP) to process its accounting transactions. The SSP's core financial system and its current configurations prevent MCC from recording certain significant transactions in a systematic and correct manner. Issues with the system posting model and related version upgrades continue to exist. Our review of the September 30, 2014 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 within the financial system's sub-modules relating to its grantees; MCC frequently has to prepare manual journal vouchers (JVs) and system's adjustments at the back end of the transactions to correct errors at the GL module level to resolve differences between the:

a) Purchase Order (PO) and GL module;
b) Accounts Payable (AP) and GL module;
c) incorrect postings;
d) system module interface errors;
e) system version upgrade issues; and
f) obligation/funding and/or disbursement corrections.

This system deficiency, combined with MCC and/or SSP's inadequate and untimely reviews and corrective actions, negatively impact MCC's ability to record transactions timely, properly, and accurately. Although MCC applied compensating controls to detect and correct these errors, with the sheer volume, amount, and complexity of these transactions (automated and manual), there is a high risk that errors will not be detected, reported, and corrected timely or not detected at all. Our audit identified instances where errors were not timely detected and resolved. These errors, if left undetected and/or uncorrected at either the financial system level or via frequent manual adjustments at the GL module level; increase the risks of material misstatements in MCC's financial statements. Moreover, this system deficiency results in inefficiencies and negatively impacts MCC's limited staff resources.

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 promptly resolved.

b. Although MCC has made strides in improving its financial reporting by further enhancing certain quality control review processes in response to prior year's findings, much still needs to be done. MCC's accounting and transactions recording process continue to be susceptible to errors even with MCC's progress in improving and resolving outstanding data errors/issues. MCC uses the Oracle federal financial management system (Oracle) to generate its financial statements. Manual journal voucher (JV) entries are posted directly into Oracle GL module to correct data errors that reside primarily within the system's sub-modules and/or post adjustments. Oracle then automatically generates the financial statements from these data inputs. Our audit identified instances where MCC posted correcting journal entries that resulted in further errors of which subsequent

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EXHIBIT 1

Material Weakness

journal entries were required to resolve the errors in Oracle at June 30, 2014 and September 30, 2014. Some of these erroneous correcting journal entries are described in c below.

c. In reviewing the financial statements and performing our internal control testing, we identified errors and control deficiencies that led us to question the effectiveness and timeliness of supervisory reviews and errors resolution. For example,
   - Reconciliation differences between AP/PO modules and GL due to SSP recording errors within Oracle.
   - Incorrect liability classification of "other liabilities" between "intragovernmental" and "with the public" of approximately $440 thousand was presented in the June 30, 2014 balance sheet due to untimely correction by MCC.
   - Certain JVs tested have inaccurate or inadequate explanation and/or supporting documentation and were posted with errors.
   - For open system tickets that remained unresolved as of quarterly reporting to OMB, MCC will post temporary JVs to its GL in order to carry out its financial reporting function. MCC will then reverse various JVs in the beginning of the new fiscal quarter in order to allow SSP time to investigate the data/recording issue. For issues that remain unresolved by the next financial reporting quarter, duplicative JVs will be posted yet again to temporarily resolve the data/recording issue.
   - For long standing issues that MCC and IBC can't resolve either individually or collectively, MCC will post JVs that do not reverse within the GL on a permanent basis in order to reflect the correct accounting transactions and/or balances. However, unresolved data issue remained within the accounting system or sub-module level. Inherently, the accounting system is unable to carry out financial reporting function without continual and persistent manual intervention by MCC financial personnel and/or financial contractors.

Recommendations

With regards to the core financial system, we repeat our prior year recommendations that MCC:

1. Perform a comprehensive review and determine whether the SSP's financial management system is meeting its financial management and reporting needs. As part of this review, management should continue to evaluate whether:
   a. a separate grants management system that focuses on program and financial administrations that interfaces with the core financial system is needed, or
   b. to establish alternatives to recording numerous data lines in the Oracle AP and PO modules which is manual intensive and prone to errors.

2. Investigate and correct the underlying causes for the system errors and limitations that prevent or delay the recording, processing, and summarizing of accounting transactions. Key issues that remain unresolved should be escalated immediately rather than back-log the problem. MCC should ensure that errors and open tickets are resolved appropriately and timely by the SSP and that routine MCA accounting activities recorded in Oracle within the specified timeline. Moreover, manual adjusting journal entries should be used for limited transactions like unusual one-time entries or correcting entries.

EXHIBIT 1

Material Weakness

3. In collaboration with the SSP, formalize in writing the system's issues and standardize the resolution processes and policy/procedures.

With regards to supervisory reviews, we recommend that MCC:

4. Further review SSP data entries relating to MCA payment processing and related adjustments (i.e. obligation/disbursement adjustments). Perform reconciliation of AP and PO on a monthly basis and proactively resolve all differences in a timely manner.

EXHIBIT 2

Significant Deficiency

1. Validation Control over Grant Accrual Estimates Needs to be Strengthened (Modified Repeat Finding)

MCC reported approximately $906 million in compact grant related expenses and an accrued grant liability of $143 million for expenditures incurred by the MCC Compact Accountable Entities [(also known as Millennium Challenge Accounts (MCAs)] but not yet paid by MCC at September 30, 2014.

A. In FY 2014, MCC continues to refine its accrual methodology and started to accumulate data store to validate its methodology. However, MCC's basis for validating the reasonableness of the grant accrual, as indicated within its *Grant Accrual Validation Whitepaper* provided on July 31, 2014, was inadequate and could not be supported. MCC is relying on an assumption that in-house invoices[1] and accrued expenses are being paid within the next 90 days. MCC had performed validation by comparing subsequent disbursements in the next 90 days against the amounts accrued. However, MCC could not provide evidence to show that this assumption was consistently reliable. Our analysis indicated that the assumption needs to be expanded and we requested MCC to expand the validation to at least 120 days in evaluating whether the accrual approximates actual.

   We also identified that the third quarter accrual estimates was substantially understated by approximately $42 million or a difference of 35 percent due to the following errors:

   - MCC did not use the current spending authority for one MCA in the accrual calculation, and
   - MCC did not confirm the calculated accrual amounts with the MCAs that were closing in FY 2014. Without confirmations, MCC should have included the unused spending authority as the grant accrual amount and not the calculated amount.

   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." "Agencies should document and maintain support for the data and assumptions used to develop grant accrual estimates. The documentation will facilitate the agency's review of the assumptions, a key internal control, and will facilitate the auditor's testing of the estimates."

B. MCC MCAs retain a percentage of the invoice amount from vendors performing large works contracts until the last payment is made based on final acceptance of the contract work completed. Given that the MCAs are on a cash basis of accounting, these contract retention costs were not being reported until the final payment was made. Consequently, MCA contract retentions were not being incorporated into the grant accrual calculation until such time as the MCA requests the funds needed to pay for them in the quarterly spending authority that is approved by MCC. As of September 30,

[1] In-house invoices are invoices received and approved by the MCAs for payment but the payment requests have not yet been submitted to the SSP for processing.

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EXHIBIT 2

Significant Deficiency

2014, the contract retentions were $23.5 million. MCC did not include these outstanding contract retentions as part of its grant accrual until year-end.

SFFAS No. 5, paragraph 19, defines a liability for federal accounting purposes as a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) non-exchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.

C. MCC's *Expense Accruals Financial Management Division Procedure Manual*, dated February 2014, does not reflect the current grant accrual validation process.

TR 12 also states that: "Documented procedures are important to communicate relevant information on the grant accrual estimation to employees and management as well as other interested parties, such as auditors. As an agency experiences employee turnover, these documented procedures can provide vital information for new employees on how to complete reliable, well supported grant accrual estimates. Such documentation may be used to establish consistent procedures for developing grant accrual estimates across grant programs with similar characteristics."

Recommendations

We recommend that MCC:

1. Update its *Expense Accruals Financial Management Division Procedure Manual* to:

    a. Provide clear guidance regarding the accrual process as it relates to compacts that are in their final year as to how the accrual will be determined;
    b. Address how contract retentions will be accounted for and included in the grant accrual estimate; and
    c. Provide a logical and supportable look-back analysis and validation process to assess the reasonableness of the grant accrual on a quarterly basis. The look-back analysis should provide MCC with sufficient and appropriate 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.

2. Ensure that policies and procedures developed are current and are fully implemented by MCC staff during the grant accrual process to avoid potential calculation errors in the future.

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EXHIBIT 3

Management's Response to Audit Findings

MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

November 12, 2014

Ms. Mia Leswing
Principal
CliftonLarsonAllen LLP
4250 N. Fairfax Drive, Suite 1020
Arlington, VA 22203

Mr. Christopher Johnson
Director, External Financial Audit Division
1300 Pennsylvania Avenue, NW
Washington, DC 20005

Dear Ms. Leswing and Mr. Johnson:

In response to the audit findings and recommendations provided in your financial statement audit report, MCC has the following comments:

Material Weakness: Ineffective and Inefficient Integration of Data, Processes, and Controls within the Financial Management Systems (Modified Repeat Finding)

Recommendations from the auditors regarding the core financial system:

1. Perform a comprehensive review and determine whether the SSP's financial management system is meeting its financial management and reporting needs. As part of this review, management should continue to evaluate whether:

    a. a separate grants management system that focuses on program and financial administrations that interfaces with the core financial system is needed, or

    b. to establish alternatives to recording numerous data lines in the Oracle AP and PO modules which is manual intensive and prone to errors.

2. Investigate and correct the underlying causes for the system errors and limitations that prevent or delay the recording, processing, and summarizing of accounting transactions. Key issues that remain unresolved should be escalated immediately rather than back-log the problem. MCC should ensure that errors and open tickets are resolved appropriately and timely by the SSP and that routine MCA accounting activities recorded in Oracle within the specified timeline. Moreover, manual adjusting journal entries should be used for limited transactions like unusual one-time entries or correcting entries.

875 Fifteenth Street NW | Washington, DC | 20005-2221 | p: (202) 521-3600 | f: (202) 521-3700 | www.mcc.gov

3-1

EXHIBIT 3

Management's Response to Audit Findings

3. In collaboration with the SSP, formalize in writing the system's issues and standardize the resolution processes and policy/procedures.

Recommendations from the auditors regarding supervisory reviews:

4. Further review SSP data entries relating to MCA payment processing and related adjustments (i.e. obligation/disbursement adjustments). Perform reconciliation of AP and PO on a monthly basis and proactively resolve all differences in a timely manner.

Response from MCC:

MCC concurs with recommendations 1 - 4.

Significant Deficiency: Validation Control over Grant Accrual Estimates Needs to be Strengthened (Modified Repeat Finding)

Recommendations from the auditors:

1. Update MCC's *Expense Accruals Financial Management Division Procedure Manual* to:

   a. Provide clear guidance regarding the accrual process as it relates to compacts that are in their final year as to how the accrual will be determined;
   b. Address how contract retentions will be accounted for and included in the grant accrual estimate; and
   c. Provide a logical and supportable look-back analysis and validation process to assess the reasonableness of the grant accrual on a quarterly basis. The look-back analysis should provide MCC with sufficient and appropriate 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.

2. Ensure that policies and procedures developed are current and are fully implemented by MCC staff during the grant accrual process to avoid potential calculation errors in the future.

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

Sincerely,

/ s /

Matthew L. Bohn
Vice President, Department of Administration and Finance
and Chief Financial Officer

3-2

EXHIBIT 4

Status of Prior Year Findings and Recommendations

As required by *Government Auditing Standards* and OMB Bulletin 14-02, 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 2013. The following analysis provides our assessment of the progress MCC has made through September 30, 2014 in correcting the noted deficiencies.

FY 2013 Findings	FY 2013 Summary of Recommendations	FY 2014 Status
Material Weakness: Ineffective and Inefficient Interrelationship among Software, Personnel, Procedures, Controls and Data within MCC's Financial Management Systems (Modified Repeat Finding)	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 whether (a) a separate grants management system that focuses on program and financial administrations that interfaces with the core financial system is needed, or (b) to establish alternatives to recording numerous data lines in the Oracle AP module which is manually intensive and prone to errors.	Open – reported as MW, modified repeat finding
	2. Investigate and correct the underlying causes for the system errors and limitations that prevent or delay the recording, processing, and summarizing of accounting transactions.	Open – reported as MW, modified repeat finding
	3. In collaboration with the SSP, formalize in writing the system's issues and resolution process.	Open – reported as MW, modified repeat finding, recommendation modified
	4. Continue to streamline the MCDR recording and adjustment process.	Closed
	5. Implement an effective management review of its accounting and financial reporting processes using the comprehensive review process.	Closed
	6. Further review SSP data entries relating to the MCA payments processing and related adjustments. Perform reconciliation of AP on a monthly basis and proactively resolve all differences.	Open – reported as MW, modified repeat finding, recommendation modified

4-1

EXHIBIT 4

Status of Prior Year Findings and Recommendations

Significant Deficiency: 1. Validation Control over Grant Accrual Estimates Needs to be Strengthened (Modified Repeat Finding)	7. Develop and implement a logical and supportable look-back validation process to assess reasonableness of the grant accrual estimate, and then perform a grant accrual look back analysis on a quarterly basis for a sufficient period of time to develop a pattern or trend.	Open – reported as SD, modified repeat finding
	8. Update the Expense Accruals Policy and Procedures to reflect the change in the methodology.	Open – reported as SD, modified repeat finding
	9. Develop audit procedures for the MCA audit to compare spending authority amount granted against actual MCA expenses, and investigate and document significant variances. MCC should maintain a library of historical MCA financial data.	Closed
	10. Continue to enhance the accrual methodology.	Closed
2. Monitoring of MCA Audits Needs to be Strengthened (Modified Repeat Finding)	11. Continue the collaboration between the USAID OIG and the MCC management to improve timelines of the MCA audits; adequacy of the MCA audit procedures; monitoring and reviewing the quality and performance of the MCA audits; and tracking and conducting follow-up of corrective action plans with the MCAs timely.	Open but will be reported as a management letter comment in FY 2014.
3. Information Systems Controls Need Improvement	12. We did not include recommendations in our audit report. Our recommendations were included in a separate USAID OIG Report titled "Audit of Millennium Challenge Corporation's Fiscal Year 2013 Compliance with Federal Information Security Management Act of 2012," Audit Report M-000-13-001-P.	Closed

4-2

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Ave, NW
Washington, DC 20523
Tel: (202) 712-1150
Fax: (202) 216-3047
www.usaid.gov/oig

Other Information

Official inauguration of the M2 road.

Millennium Challenge Corporation: Moldova

October 2014

Photo by Victor Garstea

Office of Inspector General

OCT 15 2014

Ms. Dana J. Hyde
Chief Executive Officer
Millennium Challenge Corporation
875 15th Street, NW
Washington, DC 20005

Dear Ms. Hyde:

The enclosed statement summarizes the Office of Inspector General's (OIG's) conclusions on the most serious management and performance challenges facing the Millennium Challenge Corporation (MCC). We based decisions on which challenges to report primarily on audits and analyses of MCC's operations. More challenges may exist in areas that we have not yet reviewed, and other significant findings may result from future work.

The Reports Consolidation Act of 2000 (Public Law 106-531) requires that agency performance and accountability reports include a statement prepared by each agency's inspector general summarizing the most serious management and performance challenges facing the agency and reporting the agency's progress in addressing those challenges. The enclosed statement will be included in MCC's fiscal year 2014 agency financial report.

We have discussed the management and performance challenges summarized in this statement with the responsible MCC officials. If you have any questions or wish to discuss the statement further, I would be happy to meet with you.

Sincerely,

Michael Carroll
Acting Inspector General

Enclosure: a/s

U.S. Agency for International Development
1300 Pennsylvania Avenue, NW
Washington, DC 20523
http://oig.usaid.gov

Management Challenges Identified by the Inspector General

Statement by the Office of Inspector General on the Millennium Challenge Corporation's Most Serious Management and Performance Challenges Fiscal Year 2014

The Millennium Challenge Corporation (MCC) provides foreign aid to countries that meet its policy indicators of ruling justly, investing in people, and encouraging economic freedom. By 2014, 25 countries had met these requirements and been awarded approximately $10 billion in compact agreements. The agreements are designed to reduce poverty and increase economic growth through projects in sectors such as agriculture, education, transportation, and water and sanitation. At the end of the fiscal year, MCC had eleven current compacts worth $3.8 billion: Capbo Verde II, El Salvador, Georgia II, Ghana II, Indonesia, Jordan, Malawi, Moldova, Philippines, Senegal, and Zambia. MCC continues to face its most serious management challenges in the following areas:

- Developing Compacts
- Implementing Compacts
- Sustaining Compact Benefits
- Managing Finances Efficiently

MCC has taken action to mitigate a serious challenge that was reported last year concerning its management of information technology.

Developing Compacts

MCC and its partner countries take approximately 2 years to develop compacts. They do preparatory analysis, project definition, project development and appraisal, compact negotiation and signing, and preparation for entry into force. Once a compact enters into force, the fixed, 5-year implementation period starts. The compact development process is collaborative, involving partner-country stakeholders and MCC.

A recent Office of Inspector (OIG) review identified the need for improvements in compact development, specifically in setting compensation for employees at Millennium Challenge Accounts (MCAs).

- In a July 2014 review,[1] OIG reported that MCC gave limited guidance to MCAs on compensation practices. Further, MCC did not follow its policy requiring that employment agreements for all key MCA personnel be maintained at headquarters and did not systematically share information on staffing practices at the MCAs. Finally, MCAs did not all hire key staff before entry into force, potentially delaying compact implementation.

[1] *Review of the Millennium Challenge Account Employee Compensation*, Report No. M-000-14-003-S, July 16, 2014.

1

Implementing Compacts

MCC and its partner countries, through MCAs, complete the compact implementation process over the 5-year compact term. Each MCA is staffed by a team of professionals in management, procurement, finance, monitoring and evaluation, and law and by specialists in sectors covered by the compact, such as infrastructure and agriculture. The MCA procures contractors to implement the compact projects and oversees them with the assistance of contracted specialists.

A recent audit of two projects in Namibia, the Education Project and the Tourism Project, illustrates challenges encountered during compact implementation.

- In this audit report,[2] OIG reported that although the education and tourism projects were achieving their compact goals, project implementation needed improvement. Auditors found that five of six schools visited had construction deficiencies, two of the six schools renovated with MCC funding were too small to accommodate current students, and teachers lacked training on science equipment provided by MCC. For the tourism project, the MCA had not conducted audits of environmental compliance by conservancy grantees, as required by the grants.

Sustaining Compact Benefits

To ensure that project benefits can be sustained over time, MCC requires that sustainability be part of compact design and development. Sustainability can take a number of forms, like requiring a partner country to increase its contributions to a road maintenance fund so that when the MCC-funded road is completed, the partner country has adequate funding for upkeep. A recent OIG audit[3] showed that sustainability measures could be improved.

- OIG reported that the sustainability of certain project activities was at risk. Five of six renovated schools had construction deficiencies such as cracks in walls and foundations and leaking roofs that jeopardized their functionality. Also, the MCA provided governance training to current governing representatives, but did not implement a process for transferring training knowledge to future conservancy board members.

Managing Finances Efficiently

Strong financial management is critical to effective and efficient operations. MCC must not only manage its finances well but also see that MCAs do so.

MCC received an unqualified audit opinion on its fiscal year (FY) 2013 financial statements and demonstrated progress in improving its financial management practices. The audit report cited one material weakness and three significant deficiencies in internal control. One issue in particular represents an ongoing challenge to MCC's ability to prepare complete, reliable financial statements.

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[2] *Audit of the Millennium Challenge Corporation-Funded Program in Namibia*, Report No. M-000-14-002-P, December 17, 2013.
[3] Ibid.

2

- MCC's financial management system follows the guidance prescribed by the Federal Accounting Standards Advisory Board, whereas the independent MCAs established by recipient countries do not. MCC addresses this challenge by adjusting its grant liabilities at headquarters in order to bring the cash-basis reporting by MCAs in line with MCC's accrual basis. In 2012, MCC revised its grant accrual methodology, and it now estimates accruals by examining disbursement history, unused spending authority, and invoices received but not paid. MCC continues to accumulate disbursement data from MCAs for its data warehouse use. In developing its accrual estimates, MCC also continues to implement its accrual validation process. However, accumulating sufficient MCA disbursement data to reasonably validate grant accrual estimates is still challenging and time consuming. In addition, MCC further revised its grant accrual validation process in FY 2014. As we perform the current financial statement audit, we continue to examine MCC's method for estimating accruals.

Managing Information Technology

Since FY 2008, OIG has reported information technology (IT) management challenges that affect MCC. Last year, those challenges related to MCC's privacy program, IT governance, and IT security.

This year OIG does not consider IT a management challenge. Although OIG has not yet verified whether the weaknesses were fully corrected, MCC indicated it had taken final action on significant recommendations that affect the Corporation's privacy program[4] and IT governance.[5] In addition, a recent audit[6] confirmed that MCC corrected significant IT security weaknesses that we previously reported.[7]

To keep the focus on IT in FY 2015, OIG plans to follow up on recommendations related to MCC's IT governance. In addition, OIG plans to conduct an audit of MCC's IT security, which will assess aspects of the Corporation's privacy program. Depending on the results of these audits, IT may be identified as a management challenge next year.

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[4] *Follow-up Audit of the Millennium Challenge Corporation's Implementation of Key Components of a Privacy Program for Its Information Technology Systems*, Report No. M-000-12-002-P, March 30, 2012.
[5] *Risk Assessment of the Millennium Challenge Corporation's Information Technology Governance Over Its Information Technology Investments*, Report No. M-000-11-001-O, June 1, 2011.
[6] *Audit of the Millennium Challenge Corporation's Fiscal Year 2014 Compliance With the Federal Information Security Management Act of 2002*, Report No. A-MCC-14-008-P, September 12, 2014.
[7] *Audit of the Millennium Challenge Corporation's Fiscal Year 2013 Compliance With the Federal Information Security Management Act of 2002*, Report No. M-000-13-005-P, September 20, 2013, and *Audit of the Millennium Challenge Corporation's Fiscal Year 2012 Compliance With the Federal Information Security Management Act of 2002*, Report No. M-000-13-001-P, November 6, 2012.

Management's Response to the Inspector General's Assessment of Challenges Facing MCC

TO: Michael Carroll
Acting Inspector General

FROM: Matthew L. Bohn / s /
Vice President, Administration and Finance and Chief Financial Officer

DATE: November 12, 2014

SUBJECT: Management Response to Statement by the Office of Inspector General (OIG) on MCC's Most Serious Management and Performance Challenges Fiscal Year 2014

In its *Statement by the Office of Inspector General on MCC's Most Serious Management and Performance Challenges Fiscal Year 2014,* the OIG identified four areas of concern:

1. Developing Compacts
2. Implementing Compacts
3. Sustaining Compact Benefits
4. Managing Finances Efficiently

MCC concurs that these broad areas cited are challenges to our organization. Most of the audits and reviews that support the OIG's FY 2014 statement were issued in FY 2013 or earlier, allowing MCC to complete or begin aggressive action to improve our performance. MCC thanks the OIG for acknowledging the efforts of the Office of the Chief Information Officer in successfully mitigating the serious management challenge identified in prior fiscal years.

We appreciate that the OIG recognizes our efforts to date, and we welcome your continued involvement as we improve and enhance our ability to perform MCC's mission effectively.

Developing Compacts

In the *Review of the Millennium Challenge Account Employee Compensation,* the OIG identified the need for improvement in setting compensation for Millennium Challenge Account (MCA) employees. Hiring the best talent available in-country at a competitive compensation level is critical to the successful implementation of compact programs. In response to the OIG recommendations, MCC conducted a review of key human resources processes and procedures including selection, approval and initial set-up of MCA staff; related compensation structures; subsequent modifications; and retention or termination of key staff. Following this review, MCC established a working group to develop key processes and procedures to provide direction and oversight for the adoption of comprehensive and cost effective compensation packages for MCA employees, including key staff. The working group will also develop steps toward improving the human resources process at individual MCAs. MCC recognizes the importance of addressing the management challenges outlined in the OIG report and plans to provide additional human resource management expertise to the Department of Compact Operations in FY 2015.

Implementing Compacts

MCAs continue to strengthen their oversight role in the management of contractors during project implementation. Given its focus on "country ownership", MCC works closely with each MCA to strengthen internal management and oversight capacity to the greatest extent possible. For instance, in response to the construction deficiencies noted in the OIG's report on programs in Namibia, MCC worked with MCA staff to implement an action plan for identifying and addressing outstanding contractor-related construction defects at completed schools.

The correction of construction defects, including schools rehabilitated under a compact, is subject to the terms of standard contracts that MCC ensures are used by MCAs in program implementation. These industry standard contracts require that the supervising engineer for each construction project identify and track the correction of latent defects in the completed schools that occur during the defects notification period (which lasts for one year after turnover of the rehabilitated schools from the contractor to the beneficiaries). As part of sound construction contract administration and fiduciary due diligence, MCAs withhold a performance security and a percentage of regular contract payments to ensure that the contractor completes all work to specification, including the remedy of defects under the contract. MCA-Namibia staff, with MCC support, visited the schools through the end of the defects period and found the contractors had completed work to their contractual obligation.

Project activities under compact programs are not only attempting to reduce global poverty through economic growth, but also are building the local capacity of partner countries to design, manage and be accountable for results of large complex investments. The OIG report on programs in Namibia highlighted the need to improve temporary facilities at overcrowded schools. As a result, MCC worked closely with MCA-Namibia staff as well as the Ministry of Education to identify schools in need of additional classrooms and procure pre-fabricated or modular classrooms. At the end of the compact term, MCA-Namibia built 60 pre-fabricated classrooms to meet the needs of communities, after the projects were authorized. MCA-Namibia also developed protocols that can serve as a useful model for consulting locally and nationally on infrastructure options and other work plans in response to unexpected changes in school enrollment.

Technology within the classroom creates opportunities for students to work together, such as on group projects in which students exchange ideas about the project and about how to use technology to answer their questions. The focus shifts toward more active student learning. Effective technology integration in the classroom cannot be achieved if the teachers are not fully trained in the use of the new equipment. In response to the training issue cited in the same OIG report, MCC collaborated with accountable entity staff to arrange for additional training of teachers in the renovated school by the science equipment vendors. The additional and targeted training allowed the teachers to use the science equipment more effectively in the classroom.

Lastly, MCC worked closely with MCA-Namibia to ensure that conservancy grantees conducted audits of environmental compliance, as identified by the OIG in the report of the Namibia Tourism Project, prior to the end of compact. Building capable and high-functioning local institutions is a long-term process that takes commitment and hard work. MCC firmly believes that support for this process will produce better results and use resources more efficiently.

Sustaining Compact Benefits

To ensure project benefits can be sustained over time, MCC requires that sustainability considerations be accounted for within compacts. MCC concurred with the OIG recommendation of implementing a process for transferring training knowledge to future conservancy board members. Practical and affordable training packages for future conservancy board members were included in the overall sustainability strategy developed by the accountable entities of partner countries. Furthermore, the construction deficiencies cited in the Namibia Education Project report have been corrected.

Managing Finances Efficiently

MCC noted the OIG's acknowledgement that MCC is continually improving its financial management practices, as evidenced by the unmodified opinion rendered by the independent auditing firm engaged by the OIG to conduct MCC's annual financial statement audit.

MCC's FY 2013 financial statement audit report cited one material weakness and three significant deficiencies in internal control. MCC made significant strides in FY 2014 to address the internal control issues raised by the independent auditors.

1. MCC now generates reliable, comparative financial statements directly from the financial system; thereby, mitigating risks formerly associated with manual processes and improving the overall financial reporting process.
2. In FY 2013, MCC implemented a grant expense accrual estimation methodology and validation process that, through rigorous validation in FY 2014, proved to accurately and consistently estimate grant expenses

for the first three FY 2014 accounting periods. MCC continues to refine its accrual methodology as additional historical data on grant expenses is received, examined and validated.

3. MCC instituted additional business process improvements such as: (a) an improved journal voucher process; (b) the review and correction, where necessary, of obligation and disbursement activity within the financial management system that have reduced the number of adjustments needed during quarterly financial reporting, and (c) with the assistance of and coordination with the Department of the Interior, Interior Business Center, MCC's shared service provider, a reduction in the number of open system ticket issues.

The implementation of these improvements has increased assurance that MCC is and will continue to be an excellent steward of funds, a global leader in financial data transparency and is able to achieve successfully its mission of reducing poverty through economic growth.

Summaries of Financial Statement Audit and Management Assurances

Table 1. Summary of Financial Statement Audit

Audit Opinion	Unmodified Opinion
Restatement	No

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Ineffective and Inefficient Integration of Data, Processes, and Controls within the Financial Management Systems	1				1
Total Material Weaknesses	1				1

Table 2. Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting (FMFIA Section 2)

Statement of Assurance	Unqualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Ineffective and Inefficient Integration of Data, Processes, and Controls within the Financial Management Systems	1		1			0
Total Material Weaknesses	1		1			0

Effectiveness of Internal Control over Operations (FMFIA Section 2)

Statement of Assurance	Unqualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
None Cited	0					0
Total Material Weaknesses	0					0

Conformance with Financial Management System Requirements (FMFIA Section 4)

Statement of Assurance	System Conforms

Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Weaknesses in Financial Management Systems Controls Over Monitoring and Management of Shared Service Provider and Corrective Action Implementation	0	1	1			0
Total Non-Conformances	0	1	1			0

Improper Payments Information Act Report

The Improper Payments Information Act of 2002, as amended by the Improper Payments Elimination and Recovery Act of 2010, requires Federal agencies to report annually information on improper payments to the President and Congress through their AFRs (or Performance and Accountability Reports). OMB Circular No. A-123, *Management's Responsibility for Internal Control,* Appendix C, "Requirements for Effective Measurement and Remediation of Improper Payments," Part I, defines an improper payment as any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative or other legally applicable requirements. Incorrect amounts are overpayments or underpayments made to eligible recipients (including inappropriate denials of payment or service, any payment that does not account for credits or applicable discounts, payments that are for the incorrect amount and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). In addition, when an agency's review is unable to discern whether a payment was proper because of insufficient or lack of documentation, the agency must consider this payment as improper.

Risk Assessment

MCC conducted a risk assessment for each of its eight funds. The assessment incorporated various risk factors as identified in OMB Circular No. A-123, Appendix C. Based upon the risk assessment, five funds, Compacts, CIF[1], 609(g), Administrative and Due Diligence, were considered to have a higher risk of improper payments due to the high volume of transactions and higher dollar amounts of disbursements and MCC self-identified improper payments within these funds during the risk assessment review period.[2] MCC conducted statistical sampling of these funds and determined an improper payment rate.

Statistical Sampling

The objective of sampling was to:

- Select a statistically valid random sample of sufficient size for each fund to support an estimate with a 90 percent confidence interval of +/– 2.5 percent around the estimate of the percentage of improper payments.

[1] *The CIF is consolidated with Compact Fund in "Analysis of MCC's Financial Statements" in the Management's Discussion and Analysis section of this report.*

[2] *Self-identified improper payments within the risk assessment review period were reported in the MCC FY 2013 AFR.*

- Select a representative sample for each fund to reach a conclusion on the error rate by projecting the results of the sample to the population and calculating the estimated amount of improper payments made in those funds (gross total of both over and under payments (i.e., not the net of over and under payments).

The sample size was determined using the sample size formula provided in OMB Circular No. A-123, Appendix C. MCC based the estimated percentage of erroneous payments on the improper payment error rate calculated as part of the risk assessment. To increase conservatism and coverage, MCC added 1 percent to the improper payment rate. This resulted in an increased sample size and allowed for greater assurance of the improper payment rate reported.

Using the sample size formula (adjusted to increase conservatism and coverage), MCC calculated that it needed a minimum of 62 samples to test during the FY 2014 Improper Payments Information Act reporting period. This sample size met the precision requirements specified in OMB Circular No. A-123, Appendix C.

MCC selected samples randomly from all accounting lines that composed the populations, with the exception of payroll and intra-governmental payment and collection transactions, so that each item had an opportunity for selection. MCC excluded transactions under $25,000 to focus emphasis on more material transactions and overpayments. Transactions under $25,000 did not have a significant impact on improper payment reporting thresholds.

Improper Payment Reporting

The risk assessment results did not identify any funds that met the OMB threshold of significant erroneous payments.[3] Although MCC did not meet the OMB threshold, MCC tested five of its funds to determine if it could identify any significant improper payments. MCC did not identify any improper payments from the sample of disbursements tested.

MCC determined its programs were not susceptible to significant erroneous payments, so it did not include payment recapture audits in the scope of the FY 2014 review.

[3] *Defined by OMB as gross annual improper payments in the program exceeding (1) both 1.5 % of program outlays and $10,000,000 of all program or activity payments made during the fiscal year reported, or (2) $100,000,000 (regardless of the improper payment percentage of total program outlays).*

Appendices

An agro-forestry volunteer holds a sapling at a tree nursery in Tengréla Village, Burkina Faso. The nursery, part of MCC's Agricultural Development Project, distributes seeds and saplings for reforestation and agro-forestry interventions.

Millennium Challenge Corporation: Burkina Faso

December 7, 2012

Photo by Jake Lyell for MCC

Appendix A

Acronyms

Acronym	Definition
AFR	Agency Financial Report
APR	Annual Performance Report
CDM	Continuous Diagnostic Monitoring
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIF	Compact Implementation Fund
CSRS	Civil Service Retirement System
DCO	Department of Compact Operations
DOL	Department of Labor
DPE	Department of Policy and Evaluation
FASAB	Federal Accounting Standards Advisory Board
FBwT	Fund Balance With Treasury
FECA	Federal Employees’ Compensation Act
FERS	Federal Employees Retirement System
FFMIA	Federal Financial Management Improvement Act
FISMA	Federal Information Security Management Act of 2002
FMFIA	Federal Managers’ Financial Integrity Act of 1982
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
IBC	Interior Business Center of the Department of the Interior
IG	Inspector General
IT	Information Technology
MCA	Millennium Challenge Account
MCC	Millennium Challenge Corporation
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
PP&E	Property, Plant, & Equipment
SBR	Statement of Budgetary Resources
SF	Standard Form
SFFAS	Statement of Federal Financial Accounting Standards
STEM	Science, Technology, Engineering and Math
TSP	Thrift Savings Plan
UNESCO	United Nations Educational, Scientific and Cultural Organization
USAID	United States Agency for International Development
WHO	World Health Organization

MCC is an innovative and independent U.S. foreign aid agency that is helping lead the fight against global poverty. Created by the U.S. Congress in 2004 with strong bipartisan support, MCC is changing the conversation on how best to deliver smart U.S. foreign aid by focusing on good policies, country ownership and results.

MCC Compacts

A compact is a multi-year agreement between MCC and a partner country to fund specific programs designed to reduce poverty and stimulate economic growth. Recognizing that sustainable development is achieved best by fostering country ownership, good policies and investment in people, MCC works with selected eligible countries to identify their own priorities for achieving economic growth and poverty reduction.

Every MCC compact reflects its country's specific priorities and details program objectives, implementation methods and monitoring and evaluation strategies, while ensuring financial accountability, transparency and fair and open procurement processes. To date, MCC has signed 29 compacts totaling $9.86 billion. MCC issues quarterly status reports that provide a comprehensive qualitative and quantitative snapshot of a compact project, its commitments and expenditures and its activities.

Appendix B

Summaries of FY 2014 Compact and Threshold Programs

Summary of MCC Compacts by Country

Armenia

This compact focused on increasing economic performance in the agricultural sector through strategic investments in rural roads and irrigated agriculture to provide communities and rural residents with reduced transport costs and better access to jobs, markets and social services. It increased productivity of 250,000 farmer households through improved water supply, higher yields, higher-value crops and a more competitive agricultural sector. In June 2009, MCC enacted a hold on funding for further road construction and rehabilitation because of Government of Armenia actions inconsistent with MCC principles promoting democratic governance. Armenia completed its compact in September 2011.

Benin

This compact sought to increase investment and private sector activity in Benin through four projects: (1) increasing access to land through more secure and useful land tenure, (2) expanding access to financial services through grants given to micro, small and medium enterprises, (3) providing access to justice by bringing courts closer to rural populations and (4) improving access to markets by eliminating physical and procedural constraints currently hindering the flow of goods through the Port of Cotonou. Benin completed this compact in September 2011. In 2012, MCC's Board of Directors selected Benin as eligible to develop a proposal for a second compact. Benin is currently developing a second compact under limited engagement, after it was not selected in FY 2014.

Burkina Faso

This compact is designed to (1) increase investment in rural productivity by improving land tenure security and land management, (2) increase the volume and value of agricultural production through investments in water management and irrigation, technical assistance to farmers and rural credit and (3) increase opportunities for farmers to sell agricultural goods and livestock by rehabilitating rural and primary roads. As an extension of Burkina Faso's successful threshold program, the compact also funds the construction of three classrooms each at 132 "girl-friendly" schools for grades four through six. Burkina Faso completed its compact in July 2014.

Cabo Verde

Cabo Verde's 2005 compact helped Cabo Verde achieve its national development goal of transforming its economy from aid-dependency to sustainable, private sector-led growth. The compact increased rural incomes of the poor by increasing agricultural productivity, integrating internal markets, reducing transportation costs and developing the private sector through greater private sector investment and financial sector reform. Cabo Verde completed this compact in October 2010.

The 2012 compact is comprised of two projects intended to increase household incomes by reforming two sectors identified as current constraints to economic growth: the water and sanitation sector and the land management sector. This compact builds off the success of the first compact and upholds high standards for accountability, transparency and achieving results.

El Salvador

El Salvador's 2006 compact improved the lives of Salvadorans through strategic investments in education, public services, enterprise development and transportation infrastructure. The Human Development Project increased employment opportunities for the region's poorest inhabitants and provided greater access to safe water and sanitation services. El Salvador completed this compact in September 2012.

The 2014 El Salvador Investment Compact, which was signed on September 30, 2014, is focused on improving transportation infrastructure, human capital through education and the country's investment climate.

Georgia

Georgia's 2005 compact helped reduce poverty by renovating key regional infrastructure and improving the development of regional enterprises. The compact enhanced productivity in farms, agribusinesses and other enterprises that will increase jobs and rural income; rehabilitated a major highway; and improved energy and water security. Georgia completed this compact in April 2011.

The 2013 compact is working to improve the quality of education in the science, technology, engineering and math (STEM) fields and increase the earning potential of Georgians through strategic investments from the start of a student's general education to graduation from technical training and advanced degree programs. The compact includes a focus on increasing women's participation in STEM professions.

Ghana

Ghana's 2006 compact reduced poverty by raising farmer incomes through private sector-led agribusiness development. MCC investments increased the production and productivity of high-value cash and food staple crops in some of Ghana's poorest regions and enhanced the competitiveness of Ghana's agricultural products in regional and international markets. Ghana completed this compact in February 2012.

MCC and Ghana signed the Ghana Power Compact focused on power sector reform on August 5, 2014.

Honduras

This compact sought to reduce poverty by increasing farmer productivity and entrepreneurship, and reducing transportation costs between targeted production centers and national, regional and global markets. In September 2009, MCC partially terminated the compact because of Government of Honduras actions inconsistent with MCC's eligibility criteria. Honduras completed this compact in September 2010.

Indonesia

This compact seeks to increase household incomes through three projects designed to (1) support low-carbon development by increasing productivity, reducing energy costs and improving natural resource management, (2) reduce and prevent low birth weight, childhood stunting and malnourishment of children, and (3) improve procurement of public sector growth-enhancing goods and services.

Jordan

This compact funds three integrated projects focused on improving water supply, wastewater collection and wastewater treatment and reuse. These projects are expected to improve water delivery, decrease costs of potable water and upgrade in-home water systems. They are also expected to increase the amount of wastewater collected for treatment and reduce the incidents of sewage overflow. The compact also is expected to increase the volume of treated water that is available as a substitute for freshwater for non-domestic uses.

Lesotho

This compact sought to increase water supplies for industrial and domestic use; alleviated the devastating effects of poor maternal health, HIV/AIDS, tuberculosis and other diseases by substantially strengthening the country's health care infrastructure and human resources for health capacity; and removed barriers to foreign and local private-sector investment. Lesotho completed this compact in September 2013. In December 2013, MCC selected Lesotho as eligible to develop a proposal for a second compact.

Madagascar

This compact sought to raise incomes by assisting the rural population in transitioning from subsistence agriculture to market-driven growth. The compact helped rural Malagasy secure formal property rights to land; access credit and protect savings; and receive training in agricultural production, management and marketing techniques. In August 2009, MCC terminated this compact because of Government of Madagascar actions inconsistent with MCC's eligibility criteria.

Malawi

This compact is a single-sector program focusing on activities to revitalize Malawi's power sector. By reducing power outages and technical losses, enhancing the sustainability and efficiency of hydropower generation, and improving service to electricity consumers, the compact intends to reduce energy costs to enterprises and households; improve productivity in the agriculture, manufacturing and services sectors; and preserve and create employment opportunities in the economy.

Mali

This compact sought to increase the productivity of agriculture and regional enterprises and serve as a catalyst for sustainable economic growth and poverty reduction through key infrastructure investments capitalizing on two of Mali's major assets, the Bamako-Sénou International Airport, a gateway for regional and international trade; and the Niger River, a valuable source for irrigated agriculture. In August 2012, MCC terminated the compact due to an undemocratic change in government.

Moldova

This compact will improve and provide a new model for irrigation infrastructure and management; increase the production and marketing of high-value agricultural products; and rehabilitate part of the country's national road network. The highway is a key link for passenger travel and for internal commerce and trade; the repairs will reduce the time and cost to transport goods and services, and will reduce losses to the national economy resulting from deteriorated road conditions.

Mongolia

This compact sought to improve the ability of Mongolians to register and obtain clear titles to their land, expand vocational education in core technical skills and focus on the health and well-being of the labor force by reducing non-communicable diseases and injuries. The compact also promoted alternative energy and energy-efficient products to the market economy and constructed transportation infrastructure along sections of the critical north-south road corridor. Mongolia completed this compact in September 2013.

Morocco

This compact sought to increase productivity and improved employment in high-potential sectors including investments in fruit tree productivity, small-scale fisheries and artisan crafts. Investments in financial services also supported entrepreneurship, small business development and market growth. Morocco completed this compact in September 2013. In December 2012, MCC again selected Morocco as eligible to develop a compact proposal.

Mozambique

This compact sought to increase productive capacity in selected districts by reducing the poverty rate, increasing household income and employment, and reducing chronic malnutrition. Compact projects sought to improve water systems, sanitation, access to markets, land tenure services and agriculture in the targeted districts. Mozambique completed this compact in September 2013.

Namibia

This compact aimed to improve the quality of education and training for underserved populations and capitalized on Namibia's comparative advantages, including large areas of semi-arid communal land suitable for livestock and diverse wildlife and landscapes ideal for eco-tourism. These projects are designed to increase opportunities in rural areas and increase incomes. Namibia completed this compact in September 2014.

Nicaragua

This compact was designed to reduce transportation costs, improve access to markets, strengthen property rights, increase investment and raise incomes for farms and rural businesses. In July 2009, MCC partially terminated the compact because of political conditions in Nicaragua inconsistent with MCC's eligibility criteria. Nicaragua completed this compact in May 2011.

Philippines

This compact includes funds to improve 220 kilometers of the key road in Samar province. This road will improve access to markets and services for farmers, fishers and small businesses in some of the poorest provinces in the Philippines. The compact also includes funds to expand community development projects and to computerize and streamline business processes in the Bureau of Internal Revenue to bolster the effectiveness of revenue collection and reduce opportunities for corruption.

Senegal

This compact is designed to reduce poverty and promote economic growth by unlocking the country's agricultural productivity, engaging in infrastructure projects to rehabilitate major national roads, and investing in strategic irrigation and water resources management.

Tanzania

This compact sought to rehabilitate roads to connect communities with markets, schools and health clinics, and expanded economic opportunities by reducing transport costs. It improved the reliability and quality of electric power and extended electricity services to communities previously not served. It also funded water infrastructure improvements that will increase access to potable water and mitigate incidences of water-related disease, burdensome health care costs and decreased workforce productivity. Tanzania completed this compact in September 2013.
In December 2012, MCC selected Tanzania as eligible to develop a proposal for another compact.

Vanuatu

This compact improved the country's poor road conditions by constructing and sealing two national roads, the Efate Ring Road and the Santo East Coast Road. The compact benefited poor, rural agricultural producers and the tourism industry by reducing transportation costs and improving road conditions. Vanuatu completed this compact in April 2011.

Zambia

This compact seeks to address one of Zambia's most binding constraints to economic growth through infrastructure investment in Lusaka, the rapidly urbanizing capital. The compact will invest in water supply, sanitation and drainage infrastructure to decrease the incidence and prevalence of water-related disease; reduce productive days lost due to disease and time spent collecting water; and lower costs. It also will support the Government of Zambia's ongoing efforts to reform its water sector by strengthening partner institutions.

Threshold Programs

MCC redesigned the Threshold Program in 2010 to enhance the focus on policy and institutional reform and to give candidate countries the opportunity to demonstrate that they would be good compact partners. If successfully implemented, these reforms will reduce constraints to faster economic growth and will provide MCC with critical information about the country's political will and capacity to undertake the types of reforms and investments that would have the greatest impacts in compacts.

Not all countries with threshold programs will be selected for compact eligibility. Those countries that are selected will gain significant advantages with the compact.

MCC will have greater confidence in the country partner's ability to design and implement those investments that will generate the greatest results, and MCC will have a head start on the work and relationship necessary to design a high-impact compact. In some cases, MCC may also be able to make early progress in longer duration reforms that ultimately enhance compact success, if the country becomes compact eligible.

The new threshold programs are being developed through a structured and disciplined diagnostic and design process. They begin with a rigorous analysis of the constraints to economic growth and the policies and institutions that reinforce those constraints to growth. MCC will support government efforts at reform in these areas, which have the potential for the greatest impact on growth.

The prospect of a compact program will create incentives for countries to implement the targeted reforms of the threshold program effectively and expeditiously and provide MCC with important information about the country's commitment to reform.

The second generation Threshold Program currently includes three countries. MCC signed the $15.6 million Honduras Threshold Program in August 2013. Guatemala and Nepal are in the program design phase and MCC expects to bring them to the MCC Board for approval in FY 2015.

Summary of MCC Threshold Programs

Albania

The first threshold program focused on reducing corruption by reforming tax administration, public procurement and business administration. It sought to reduce bribes and bureaucracy related to starting a business and to increase the national tax base. In October 2008, MCC signed a second threshold program with Albania.

The second program built upon the successes of the first and focused on anti-corruption through targeted reforms in the areas of public administration and judicial capacity building. Albania completed both programs.

Burkina Faso

This program focused on increasing the number of girls completing primary education. The program included the construction of "girl-friendly" schools, teacher training, take-home dry rations for girls who maintain a 90 percent school attendance rate and literacy training center for mothers. Burkina Faso completed its threshold program in September 2008; it signed an MCC compact in July 2008.

Guyana

This program sought to improve Guyana's fiscal policies and create a more business-friendly environment. The grant helped the Government of Guyana implement a new value-added tax system and develop ways to assist and educate taxpayers, while better planning and controlling spending. The program was designed to reduce the number of days and costs to start a business by modernizing and streamlining the business registration process. Guyana completed its threshold program in February 2010.

Honduras

This 3-year program aims to bring good governance practices to Honduras by improving public financial management and creating more effective and transparent public-private partnerships. It follows the successful implementation of the country's compact, which closed in September 2010. The threshold program agreement was signed in August 2013. The program will help the Government of Honduras save money in providing public services, improving the delivery of public services and reducing opportunities for corruption. MCA-Honduras, a Honduran government organization set up under the previous MCC compact but now used by multiple donors, will manage the threshold program. The U.S. Treasury Office of Technical Assistance will implement a portion of the Public Financial Management Project, and MCC will oversee the implementation, monitoring and evaluation of the threshold program.

Indonesia

This program sought to immunize at least 80 percent of children under the age of one for diphtheria, tetanus and pertussis and 90 percent of all children for measles. The program also included a component aimed at curbing public corruption by reforming the judiciary. Indonesia completed its threshold program in December 2010; it signed an MCC compact in November 2011.

Jordan

This program strengthened democratic institutions by supporting Jordan's efforts to broaden public participation in the political and electoral process, increasing government transparency and accountability and enhancing the efficiency and effectiveness of customs administration. Jordan completed its threshold program in August 2009; it signed an MCC compact in October 2010.

Kenya

This program focused on reducing opportunities for corruption in public governance. The program targeted corruption in public procurement, the delivery of health care and the monitoring and evaluation of reforms. Kenya completed its threshold program in December 2010.

Kyrgyz Republic

This program sought to increase the independence and effectiveness of the judicial system, develop a more functional and trusted police force, improve the government's capacity to investigate and prosecute corruption cases, educate the public and media on the dangers of corruption and strengthen the financial disclosure system. The Kyrgyz Republic completed its threshold program in June 2010.

Liberia

This 3-year program promoted equal access to land and increased land security through better understanding of property rights issues and improved land administration. The program also focused on improving girls' primary education enrollment and retention, and supported efforts to improve trade policy and practices, specifically in harmonizing tariffs, engaging regional and global bodies and strengthening the regulatory environment. In December 2012, MCC selected Liberia as eligible to develop a compact. Liberia completed its threshold program in December 2013.

Malawi

This program focused on combating corruption, enhancing oversight functions and building enforcement and deterrence capacity. The program strived to create more effective legislative and judicial branches of government, provide support for anti-corruption agencies, strengthen independent media coverage and expand the work of civil society organizations. Malawi completed its threshold program in September 2008; it signed a compact in April 2011.

Moldova

This program sought to reduce corruption in the public sector through reforms to the judicial, health, tax and customs systems. The reforms complemented Moldova's national strategy aimed at reducing corruption. Moldova completed its threshold program in February 2010; it signed an MCC compact in January 2010.

Niger

This program focused on reducing public corruption within the health and education sectors; streamlining the process of starting a business; reducing the time and costs associated with land ownership transfer, land valuation, building permitting and notarization; and bolstering girls' education. In December 2009, MCC voted to suspend MCC's program with Niger based on Government of Niger actions inconsistent with MCC policies; MCC reinstated assistance under the program in December 2011. In August 2012, USAID began implementation of a $2 million program to complete and extend the activities of Niger's original threshold program. The program, approved by the MCC in March 2012, supported school-based strategies to improve academic performance and to increase girls' enrollment, retention and completion. In December 2012, MCC selected Niger as eligible to develop a compact.

Paraguay

The first Paraguay threshold program focused on reducing corruption. The program sought to strengthen the rule of law by increasing penalties for corruption and building a transparent business environment. Additionally, it included a business development component aimed at reducing the number of days necessary to start a business. Paraguay completed its first threshold program in August 2009.

In April 2009, MCC signed a second threshold program with Paraguay that built upon the successes of the first program. It focused on anti-corruption efforts in sectors that are especially prone to corruption and are of economic importance, such as customs, law enforcement, health care and the judiciary. The goal was not only to reduce opportunities for corruption and increase successful prosecution of wrongdoers, but also to improve public understanding and perception of these sectors and reinforce the Government of Paraguay's commitment to combating corruption. Paraguay completed its second threshold program in July 2012.

Peru

This program sought to increase immunization rates of children in rural areas against diseases like measles, diphtheria, pertussis and tetanus in eight targeted regions, and assist Peru's Ministry of Health in strengthening information and vaccination management systems. The program also helped Peru combat corruption by working with the government and civil society organizations to improve internal controls, as well as analyze and simplify administrative processes to reduce opportunities for corruption. Peru completed its program in September 2012.

Philippines

This program sought to improve revenue administration and anti-corruption efforts by strengthening the Office of the Ombudsman and strengthening enforcement within three departments in the Department of Finance. The Philippines completed its threshold program in May 2009; it signed an MCC compact in September 2010.

Rwanda

This program focused on strengthening civic participation and promoting civil liberties by providing training, technical support and grants to local and national civil society organizations, and supporting independent community radio stations to enhance citizen engagement. The program also reinforced Rwanda's efforts to support judicial capacity building legislative reforms and to improve overall public administration. Rwanda completed its threshold program in December 2011.

Saõ Tomé and Principe

This program sought to increase revenue through improved tax administration and enforcement. The program also modernized Saõ Tomé and Principe's customs service to increase efficiency and reduce the time and cost of starting a business. Saõ Tomé and Principe completed this threshold program in April 2011.

Tanzania

This program focused on four specific anti-corruption initiatives, including building the nongovernmental sectors' monitoring capacity; strengthening the rule of law for good governance; establishing a Financial Intelligence Unit; and curbing corruption in public procurement. Tanzania completed its threshold program in December 2008; it signed an MCC compact in February 2008.

Timor-Leste

This program sought to reduce corruption by building a network of functioning and effective anti-corruption institutions and actors strengthening capacity, increasing coordination and improving processes and procedures to deter and detect instances of corruption. The program also aimed to improve access to immunization services by creating a more capable and effective community health system. Timor-Leste completed its threshold program in March 2014.

Uganda

This program focused on reducing corruption by improving public procurement and financial management practices, strengthening the role of civil society and building capacity to facilitate more effective follow-up of reported malpractices. Uganda completed its threshold program in December 2009.

Ukraine

This program focused on reducing corruption by strengthening civil society's ability to monitor and expose it. The program also enabled the Government of Ukraine to increase monitoring and enforcement of ethical and administrative standards. Ukraine completed its threshold program in December 2009.

Zambia

This program focused on reducing corruption and improving government effectiveness. The program funded three components aimed at (1) increasing control of corruption within the public sector, (2) improving public service delivery to the private sector and (3) strengthening border management of trade. Zambia completed its threshold program in February 2009; it signed an MCC compact in May 2012.

Selection Indicators

MCC uses a variety of indicators within the categories of economic freedom, investing in people and ruling justly to determine country eligibility for program assistance. It looks at several elements in choosing selection indicators, including:

- Development by a third party
- Linkage to policies that the government can influence within a 2–3 year horizon
- Linkage—theoretically or empirically—to economic growth and poverty reduction
- Use of an analytically rigorous methodology and objective and high-quality data
- Broad country coverage and comparability across countries
- Consistency in results from year-to-year

The table below lists the indicators and sources of information used to determine country eligibility for MCC program assistance. The indicators are grouped by category.

Selection Indicators

Category	Indicator	Source
Economic Freedom	Access to Credit Indicator	International Finance Corporation
	Business Start-Up Indicator	International Finance Corporation
	Fiscal Policy Indicator	International Monetary Fund
	Gender in the Economy Indicator	International Finance Corporation
	Inflation Indicator	International Monetary Fund
	Land Rights and Access Indicator	International Fund for Agricultural Development
	Regulatory Quality Indicator	World Bank/Brookings Institution
	Trade Policy Indicator	The Heritage Foundation
Investing in People	Child Health Indicator	Columbia University/Yale University
	Girls' Primary Education Completion Rate Indicator (Lower Income Country only)	UNESCO
	Girls' Secondary Education Enrollment Ratio Indicator (Lower Middle Income Country only)	UNESCO
	Health Expenditures Indicator	World Health Organization (WHO)
	Immunization Rates Indicator	WHO/UNICEF
	Natural Resource Protection	International Finance Corporation/ Columbia University/Yale University
	Primary Education Expenditures Indicator	UNESCO

Appendix C

MCC Country Selection Process

If you are reading a paper copy of this document, you will find the Selection Indicators table at the following MCC website address: http://www.mcc.gov/pages/selection/indicators.

The table on the website is sorted by indicator, category, and source. You can click on individual indicators and sources for additional information.

If you are reading a paper copy of this document, you will find the website addresses for these documents in Appendix D.

Selection Indicators

Category	Indicator	Source
Ruling Justly	Civil Liberties Indicator	Freedom House
	Control of Corruption Indicator	World Bank/Brookings Institution
	Freedom of Information Indicator	Freedom House/Fringe
	Government Effectiveness Indicator	World Bank/Brookings Institution
	Political Rights Indicator	Freedom House
	Rule of Law Indicator	World Bank/Brookings Institution

Use of Supplemental Information

MCC's Board of Directors may also take into account other quantitative and qualitative information. It uses supplemental information to inform its understanding of a country's policy performance relative to its peers, and MCC's ability to reduce poverty and generate economic growth in a country.

There are elements of the eligibility criteria set out in MCC's legislation for which there is either limited quantitative information or no well-developed performance indicator, so MCC may turn to supplemental sources for assessments of these policy issues. In addition, the Board may consider whether there are data gaps or lags in particular indicators that can be addressed by supplemental information.

Examples of the supplemental information used by MCC include the reports listed below.

- The U.S. Department of State's Human Rights Report
- The U.S. Department of State's Trafficking in Persons Report
- Transparency International's Corruption Perceptions Index
- Global Integrity Report
- Freedom House's Countries at the Crossroads
- The World Bank's World Development Indicators
- The World Bank's Doing Business Report
- The World Economic Forum's Global Competitiveness Report

Appendix D

Useful Websites

The following websites contain additional information related to MCC activities. This Appendix includes documents referenced in this report and will help readers who are reading a paper copy of this report locate the links embedded in the electronic version.

http://**www.mcc.gov**

MCC's website, which contains a wide variety of information about MCC's programs and activities. There are links to MCC's electronic versions of this AFR and previous reports, Annual Reports, and the Congressional Budget Justifications, which contain the APRs. In addition, there are links to selection indicators, evaluations, and individual country reports.

https://**www.mcc.gov**/pages/contact

Contact for comments or questions about this report.

http://**www.state.gov**/j/drl/rls/hrrpt/index.htm

The U.S. Department of State's Human Rights Report.

http://**www.state.gov**/j/tip/rls/tiprpt/index.htm

The U.S. Department of State's Trafficking in Persons Report.

http://**www.transparency.org**/research/cpi/overview

Transparency International's Corruption Perceptions Index.

http://**data.worldbank.org**/indicator

Global Integrity Report.

http://**www.freedomhouse.org**/report/countries-crossroads/countries-crossroads-2012

Freedom House's Countries at the Crossroads.

http://**data.worldbank.org**/indicator

The World Bank's World Development Indicators.

http://**www.doingbusiness.org**

The World Bank's Doing Business Report.

http://**www.weforum.org**/issues/global-competitiveness

The World Economic Forum's Global Competitiveness Report.

http://**www.fasab.gov**

The Federal Accounting Standards Advisory Board website. The MCC prepares its financial statements in accordance with GAAP promulgated by FASAB.

http://**www.whitehouse.gov**/omb

OMB's website, which contains Circulars No. A-123 and A-136 that MCC follows to prepare its FMFIA and financial reports.

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Washington, DC 20005-2221
www.mcc.gov

2014-001-1600