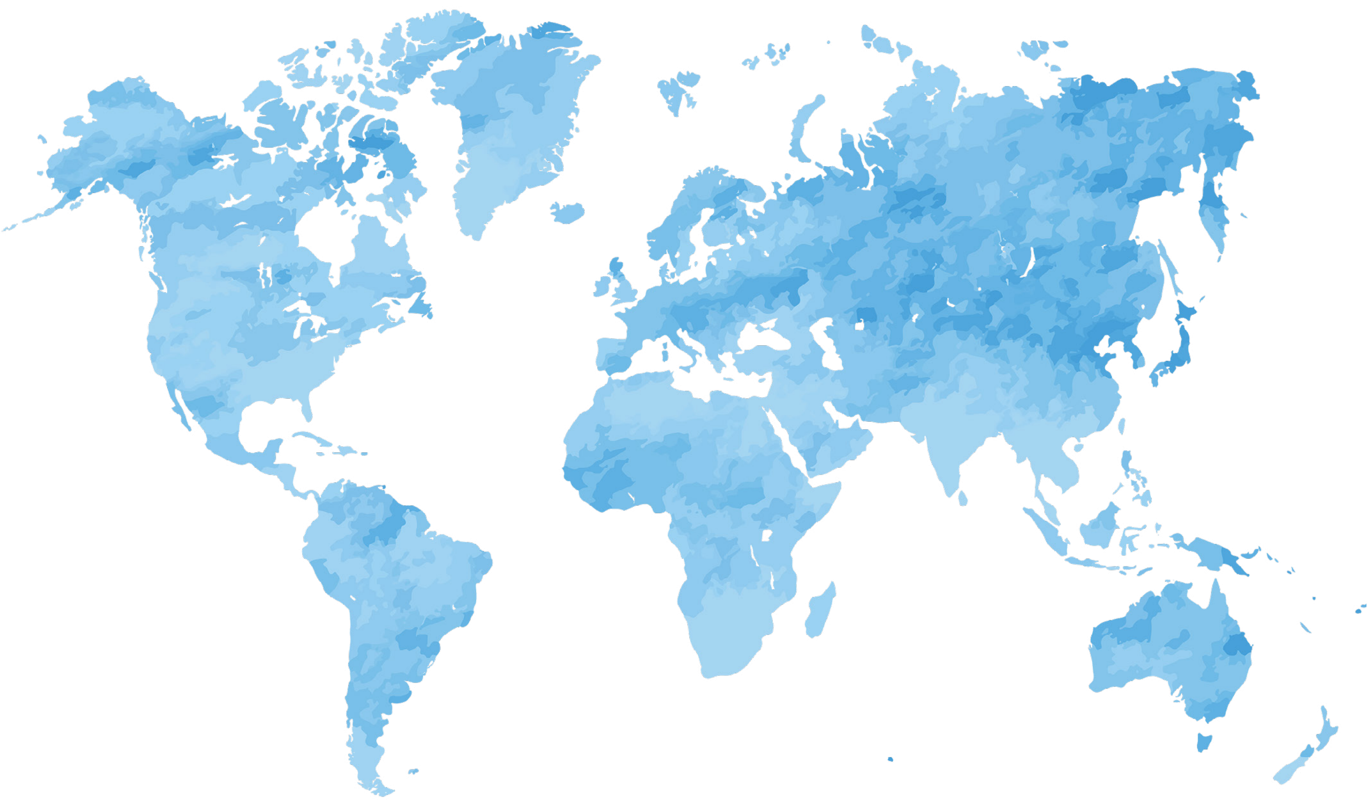
Millennium Challenge Corporation

Agency Financial Report

Fiscal Year 2016



October 1, 2015 – September 30, 2016

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.

Country name badge and map color denote current status (blends indicate multiple, concurrent status), rectangular badges denote previous status.

MILLENNIUM
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UNITED STATES OF AMERICA

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Contents

Introduction

MCC's Agency Financial Report (AFR) for fiscal year (FY) 2016 provides the fiscal results that enable the President, Congress, and the American people to assess MCC's performance for the reporting period beginning October 1, 2015, and ending September 30, 2016. In particular, the AFR provides an overview of MCC's programs, accomplishments, challenges, and management's accountability over 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 will also prepare an Annual Performance Report (APR) for FY 2016 that will be included in MCC's FY 2018 Congressional Budget Justification (CBJ). The APR will be posted on MCC's website in February 2017. Together, the AFR and APR provide a comprehensive presentation and disclosure of important financial and programmatic information related to MCC's operations and results, including a fair assessment of MCC's leadership and stewardship of the resources entrusted to the agency. MCC provides further information related to its activities in an Annual Report to its Board of Directors, Congress, stakeholders, and the public on its website.

Organization of This Report

The FY 2016 AFR includes a message from the Chief Executive Officer (CEO), followed by three sections and appendices:

- **Section I: Management's Discussion and Analysis** integrates performance and financial information with key performance results, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems.
- **Section II: Financial Section** contains a message from the Acting Vice President, Department of Administration and Finance and Chief Financial Officer (CFO), the financial statements and accompanying notes, and the independent auditor's report.
- **Section III: Other Information** includes the Combined Schedule of Spending, Office of Inspector General's (OIG's) summary of top management challenges, MCC Management's response to this summary, and MCC's Improper Payments Information Act (IPIA) Report.
- **Appendix A** includes a list of acronyms used in this report.

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

Message from the Millennium Challenge Corporation's Chief Executive Officer

November 16, 2016

The Millennium Challenge Corporation (MCC) was founded on the principle that accountability is essential to its mission of reducing poverty through economic growth. Since then, MCC has maintained a rigorous commitment to results-driven, transparent development and it is my privilege to share with you MCC's 2016 Agency Financial Report (AFR).

During fiscal year (FY) 2016, MCC continued to advance programs that transform lives and create opportunity for people around the world. MCC signed new programs with Liberia, Morocco, Niger, and Sierra Leone that will unlock economic growth and lift up some of the world's poorest communities. The agency also completed an innovative compact in the Philippines, where MCC funded thousands of community-led infrastructure projects and improved the government's ability to collect tax revenue so it can invest more in its people.

At the same time, MCC was again recognized for its commitment to transparency and accountability in 2016. The agency ranked first in the U.S. Government and second among all international donors in transparency in Publish What You Fund's Aid Transparency Index, and MCC scored the highest among seven federal agencies in Results for America's Federal Invest in What Works Index.

I am particularly pleased to note that in FY 2016, MCC received an unmodified clean opinion on its financial statements for the sixth year in a row, and for the second time since MCC's inception, the independent auditors' report did not identify any material weaknesses in our internal control system. The opinion rendered by MCC's auditors reaffirms our dedication to fulfilling our fiduciary responsibility to the American people.

As MCC looks to the future, it is focused on continuing to deliver effective, data-driven development that American taxpayers can be proud of. This year, MCC released a strategy to broaden and deepen its impact—NEXT—that reflects MCC's commitment to transparency and accountability at every stage of its work.

The financial and performance information presented in this AFR helps tell the story of MCC's impact to date in implementing best practices in development to end global poverty. Please see my annual assurance statement, also included in this report, for information on MCC's compliance with appropriate financial laws and regulations.

I invite our stakeholders to follow MCC's work and share your feedback. As MCC forges a path forward, it is committed to strengthening its approach and maximizing its impact in the fight against global poverty.

Dana J. Hyde
Chief Executive Officer

Management's Discussion and Analysis

Mission, Values and Organizational Structure

Mission

The Millennium Challenge Act of 2003, 22 United States Code (U.S.C.) 7701-7718, established MCC as a wholly-owned Government Corporation, as defined by the Government Corporation Control Act. MCC transforms lives and creates opportunity by partnering with impoverished nations. To be eligible for MCC assistance, a country must demonstrate a commitment to just and democratic governance, economic freedom, and investment in its own people.

Good governance includes democratic rights and the rule of law, respect for human and civil rights, protection of private property rights, transparency and accountability in governance, and a commitment to fight against corruption. Economic freedom requires policies that enable citizens and firms to participate in global product and capital markets, promote private sector growth, and limit direct government interference in the economy. Investment in people encompasses investments in education and health care for a country's own citizens, with a particular emphasis on women and children.

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

- A ***compact*** provides for a five-year grant to a country that meets MCC's eligibility criteria and is selected for assistance by MCC's Board of Directors. The compact establishes a multi-year plan of partnership between the country and MCC to achieve shared development objectives. The compact defines responsibilities including benchmarks, timetables, and performance goals; and establishes an investment program built on transparency, accountability, sustainability, and the involvement of business communities as well as private and voluntary organizations.
- A ***threshold*** grant 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's grant programs are focused on various sectors, including agricultural development, education, enterprise and private sector development, governance, health, water and sanitation, irrigation, transportation, electricity, and trade and investment capacity-building. MCC's governing statute requires MCC to provide assistance in a manner that promotes economic growth and the elimination of extreme poverty.

MCC is just one member of the U.S. Government's (USG) international development community. MCC works closely with the Department of State, the United States Agency for International Development (USAID), and other USG agencies to ensure that MCC programs complement related USG efforts to maximize the impact of MCC's investments around the world. 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, a result that promotes America's national security interests.

Values

MCC's values define how we operate on a daily basis, both as individuals and as an institution, in pursuit of MCC's mission. Our values identify who we are and what is important to us. They guide how we make decisions, set priorities, address challenges, manage trade-offs, recruit and develop staff, and work together with our partner countries and stakeholders.

Our 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 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 learning opportunity, 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 one another 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 and foster strong working relationships with our colleagues at MCC, in our partner countries, and throughout the development community.

Organizational Structure

Board of Directors

MCC is overseen by a nine-member Board of Directors that is chaired by the Secretary of State. The Board of Directors also includes the Secretary of the Treasury, who acts as the Vice Chair, the U.S. Trade Representative, the USAID Administrator, MCC's CEO, and four private sector representatives appointed by the President of the United States with the advice and consent of the U.S. Senate. The Board of Directors meets four times each year to, among other responsibilities, provide policy guidance to the Corporation, make annual eligibility determinations, and approve compact and threshold programs.

Executive Offices

MCC accomplishes its mission through the following executive offices:

Office of the Chief Executive Officer is led by the Senate-confirmed CEO and provides executive leadership and strategic direction for the agency; coordinates activities and communications across departments; manages the agency's Investment Management Committee; and oversees overall agency performance and day-to-day operations.

Department of Compact Operations manages the operational relationships with MCC partner countries; leads MCC's work in developing and implementing high-impact, sustainable economic development projects around the world; provides technical and regional expertise and rigorous oversight of USG resources to address constraints to economic growth and reduce poverty; and works with other international development agencies and the private sector to coordinate efforts within MCC partner countries. The department divides the management of the MCC compact portfolio into two regional divisions, (1) Africa and (2) Europe, Asia, the Pacific and Latin America, and two technical divisions, (1) Sector Operations and (2) Infrastructure, Environment and the Private Sector. Its staff has expertise in a wide range of areas, including education, fiscal accountability,

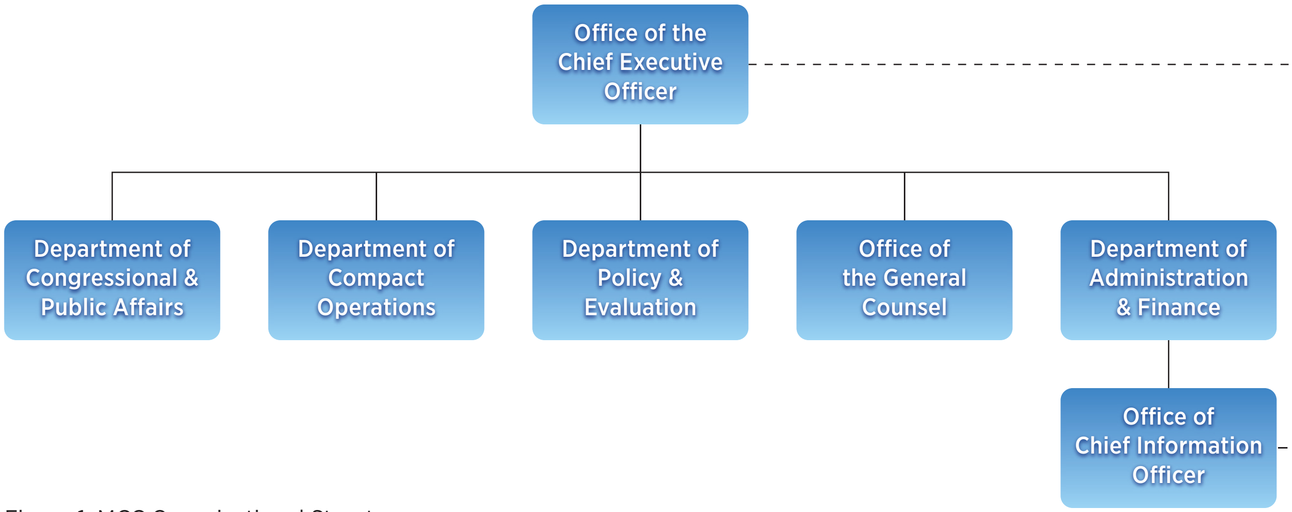

Figure 1. MCC Organizational Structure

infrastructure, agriculture, land policy, procurement, environmental and social performance, gender integration, private sector engagement, and human and community development.

Department of Policy and Evaluation manages MCC's annual country eligibility process and the development and implementation of threshold programs. The department also promotes effective policy improvement and reform; performs economic analysis and monitoring; oversees rigorous independent evaluations; and provides institutional leadership on interagency engagement.

Office of General Counsel advises MCC's Board of Directors and staff on all legal issues affecting MCC, its programs, policies, and procedures; provides counsel on all legal aspects of country eligibility, threshold programs, and other policy initiatives; addresses and resolves legal issues associated with compact programs; conducts and evaluates due diligence on country proposals; leads compact negotiations; provides advice on all issues affecting the internal operations of MCC; advises on matters of statutory interpretation, interagency agreements (IAAs) and communications, and other public initiatives; leads MCC's Anti-Fraud and Corruption Program; serves as Corporate Secretary to the MCC Board of Directors; and manages MCC's ethics program, providing related training and guidance to staff.

Department of Congressional and Public Affairs manages MCC's relationship with Congress, USG agencies, the media, universities, nongovernmental organizations, think tanks, the private sector, and other key groups interested in MCC's mission. It handles all media inquiries and interview requests, manages the MCC Speakers Bureau, coordinates all public events, serves as a liaison to staff of the MCC's Board of Directors, maintains MCC's public website, and disseminates information to the public via statements, press releases, and speeches, among other means.

Department of Administration and Finance 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; provides administrative services; oversees and administers MCC's Enterprise Risk Management program; maintains official corporate records; coordinates audit interactions with the OIG and the Government Accountability Office (GAO); coordinates and ensures timely and relevant reporting of performance data on compact programs. There is a dotted reporting line between the Chief Information Officer (CIO) and the CEO. The Office of the CIO oversees corporate IT investments on behalf of the Corporation.

Staffing

MCC is a small government corporation headquartered in Washington, DC. Table 1 shows Federal employee staffing levels from FY 2014 through FY 2016.

Table 1. MCC Staffing — Full Time Equivalent (FTE)*

	FY 2016	FY 2015	FY 2014
Headquarters	266	254	263
Overseas	24	22	21
Total	**290**	**276**	**284**

Staffing report based on Standard Form (SF)-113A and SF-113G reporting of FTE calculations based on the fourth of each FY.

Performance Goals, Objectives, and Results

MCC is a small, independent USG agency with an innovative and tested approach to fighting global poverty. MCC's mission is to reduce poverty by supporting sustainable economic growth in selected developing countries that demonstrate a commitment to sound policies in the areas of democratic governance, economic freedom, and investment in people. MCC achieves this mission by addressing policy issues and investing in large-scale grant programs in various sectors to unlock economic growth in our partner countries and help people lift themselves out of poverty. Our infrastructure investments are in various sectors such as power, agriculture, clean water, and roads. MCC's approach employs development best practices on selection, country ownership, and accountability; drives policy reform with analysis and data-driven decision-making; and leverages partnerships with donors and the private sector.

As part of its FY 2018 Congressional Budget Justification, MCC will provide an APR, which will be available in February 2017. A high-level summary of MCC's strategic direction and performance during FY 2016 follows.

Strategic Direction

In February 2016, MCC launched a five-year strategic plan called *NEXT.* Based on a comprehensive review of MCC's experiences and lessons learned over its first 10 years of operations, *NEXT* charts a course to expand MCC's impact through new strategic directions, while doubling down on the core strengths of the MCC model. The plan sets forth five strategic goals to frame and guide the agency's work moving forward:

- **GOAL 1:** Help countries choose evidence-based priorities in growth and poverty reduction strategies that reflect new learning and new **opportunities.**
- **GOAL 2:** Strengthen reform **incentives** and accountability.
- **GOAL 3:** Capitalize on public and private partnerships for more impact and **leverage.**
- **GOAL 4:** Lead data and results **measurement,** learning, transparency, and development effectiveness.
- **GOAL 5:** Maximize internal efficiency and productivity. Maintain and motivate a **world** class, high-functioning staff.

Under each strategic goal, *NEXT* defines a set of priority actions that will collectively guide MCC's annual corporate and business planning efforts, starting with FY 2017. You can find out more about *NEXT* on MCC's website (www.mcc.gov/resources/pub/next)

For FY 2016, prior to the adoption of *NEXT* but cognizant of ongoing work, MCC established the following corporate goals to guide agency activities:

- Empower staff to better fulfill our agency mission and improve organizational health and staff morale.
- Deliver high quality MCC investments and partnerships.
- Strengthen analytical tools and continue to lead measurement and reporting results.
- Improve operational efficiency and effectiveness by enhancing knowledge management, business processes, and systems.
- Expand the MCC model for greater impact and to enable the agency to continue to fulfill our mission.

These FY 2016 corporate goals are reflected in the work and activities discussed in this AFR.

Snapshot of MCC Portfolio and Programming

As of September 30, 2016, MCC is currently engaged in partnerships with 24 countries (including compacts and threshold programs). Table 2 displays the number of countries in the development and implementation phases of compacts and threshold programs.

Table 2. MCC Portfolio as of Sept. 30, 2016
7 Countries in Compact Development
12 Countries in Compact Implementation
2 Countries in Threshold Program Development
3 Countries in Threshold Program Implementation

MCC publishes quarterly status reports that provide a comprehensive, qualitative, and quantitative snapshot of each compact project, its commitments and expenditures, and its activities.

Table 3 displays grant totals, net of de-obligated amounts, for each country with which MCC has had a signed compact since the agency's inception through September 30, 2016.

Table 3. Value of Compact Grants as of September 30, 2016 (in thousands)

TOTAL	**$ 11,258,544**	*(100.0%)*
Tanzania	$ 694,546	*(6.2%)*
Morocco	$ 650,164	*(5.8%)*
Indonesia	$ 600,000	*(5.3%)*
Ghana	$ 536,289	*(4.8%)*
Ghana II	$ 498,200	*(4.4%)*
Burkina Faso	$ 474,744	*(4.2%)*
Morocco II	$ 450,000	*(4.0%)*
El Salvador	$ 449,567	*(4.0%)*
Mozambique	$ 447,905	*(4.0%)*
Niger	$ 437,024	*(3.9%)*
Mali	$ 434,287	*(3.9%)*
Senegal	$ 433,318	*(3.8%)*
Philippines	$ 433,088	*(3.8%)*
Georgia	$ 387,179	*(3.4%)*
Benin II	$ 375,000	*(3.3%)*
Lesotho	$ 358,046	*(3.2%)*
Zambia	$ 354,758	*(3.2%)*
Malawi	$ 350,700	*(3.1%)*
Benin	$ 301,810	*(2.7%)*
Namibia	$ 295,719	*(2.6%)*
El Salvador II	$ 277,000	*(2.5%)*
Jordan	$ 275,100	*(2.4%)*
Mongolia	$ 268,994	*(2.4%)*
Moldova	$ 259,372	*(2.3%)*
Liberia	$ 256,726	*(2.3%)*
Honduras	$ 204,015	*(1.8%)*
Armenia	$ 176,550	*(1.6%)*
Georgia II	$ 140,000	*(1.2%)*
Nicaragua	$ 112,703	*(1.0%)*
Cabo Verde	$ 108,512	*(1.0%)*
Madagascar	$ 85,594	*(0.8%)*
Cabo Verde II	$ 66,230	*(0.6%)*
Vanuatu	$ 65,404	*(0.6%)*

In total, since MCC began operations in 2004, 27 countries have received funding through 33 compacts (Benin, Cabo Verde, El Salvador, Georgia, Ghana, and Morocco have signed two compacts each), and 24 countries have received funding through 26 threshold programs (Albania and Paraguay each signed two). Burkina Faso, Honduras, Indonesia, Jordan, Malawi, Moldova, Niger, Philippines, Tanzania, and Zambia have signed both compacts and threshold agreements.

In FY 2016, MCC signed three new compacts (Liberia, Morocco II, and Niger) and closed one compact (Philippines). MCC also signed one new threshold program (Sierra Leone).

MCC's Approach to Results and Performance Measurement

Overview

MCC is committed to achieving and measuring results; holding itself accountable for those results; transparently reporting results, data, and evaluations; and learning from the evidence to improve future programs. To fulfill this commitment, data-driven decision-making and monitoring and evaluation (M&E) are integrated into the entire program life-cycle, from country selection, to program conceptualization, to implementation and beyond.

First, MCC chooses partners based on 20 publicly available indicators that measure democracy, good governance, and sound economic and social policies.

During program development, proposed investments, focused on alleviating binding constraints to growth, are identified through a rigorous, data-driven methodology. In addition, a clear program logic, indicators, baselines, milestones, targets, and benchmarks are typically identified to measure progress over the life of the program.

After a compact or threshold program grant is signed, the partner country's accountable entity (also referred to as Millennium Challenge Account [MCA]) and MCC finalize an M&E plan for the program that provides the framework for monitoring and evaluating program activities. (Note: this structure may differ for threshold programs.)

The monitoring component of the M&E plan lays out the methodology and process for assessing progress toward the program goal. It identifies indicators, establishes performance milestones and targets, and provides details on the plan for data collection and reporting that will allow the MCA and MCC to track progress against targets on a regular basis.

The evaluation component identifies and describes the evaluations that will be conducted, the key evaluation questions and methodologies, and the data collection strategies that will be employed. M&E plans are revised as needed during the life of the program to adjust to changes in the program's design and to incorporate lessons learned for improved performance monitoring and measurement.

Figure 2 illustrates how results for the various phases are tracked and become part of a feedback loop to improve performance during a compact and to apply lessons learned to future compacts.

Building on MCC's commitment to assess and measure results transparently, in FY 2016 MCC assessed conceptual options to develop and deploy an enhanced consolidated results framework, with the objective of better capturing MCC's influence and impact. An updated results framework would leverage MCC's already robust system to capture program inputs, outputs, and outcomes by adding several dimensions designed to measure broader systemic impact and agency performance in achieving institutional goals, including corporate effectiveness and efficiency. This work will continue in FY 2017.

Monitoring Program Performance

MCC monitors progress by using performance indicators that measure progress at all levels. Lower-level process and output level indicators are typically drawn from project and activity work plans, whereas higher-level targets are often linked directly to the economic rate of return analysis. MCC conducts this analysis to estimate the impacts of the investment, drawing from benefit streams. MCC reviews data

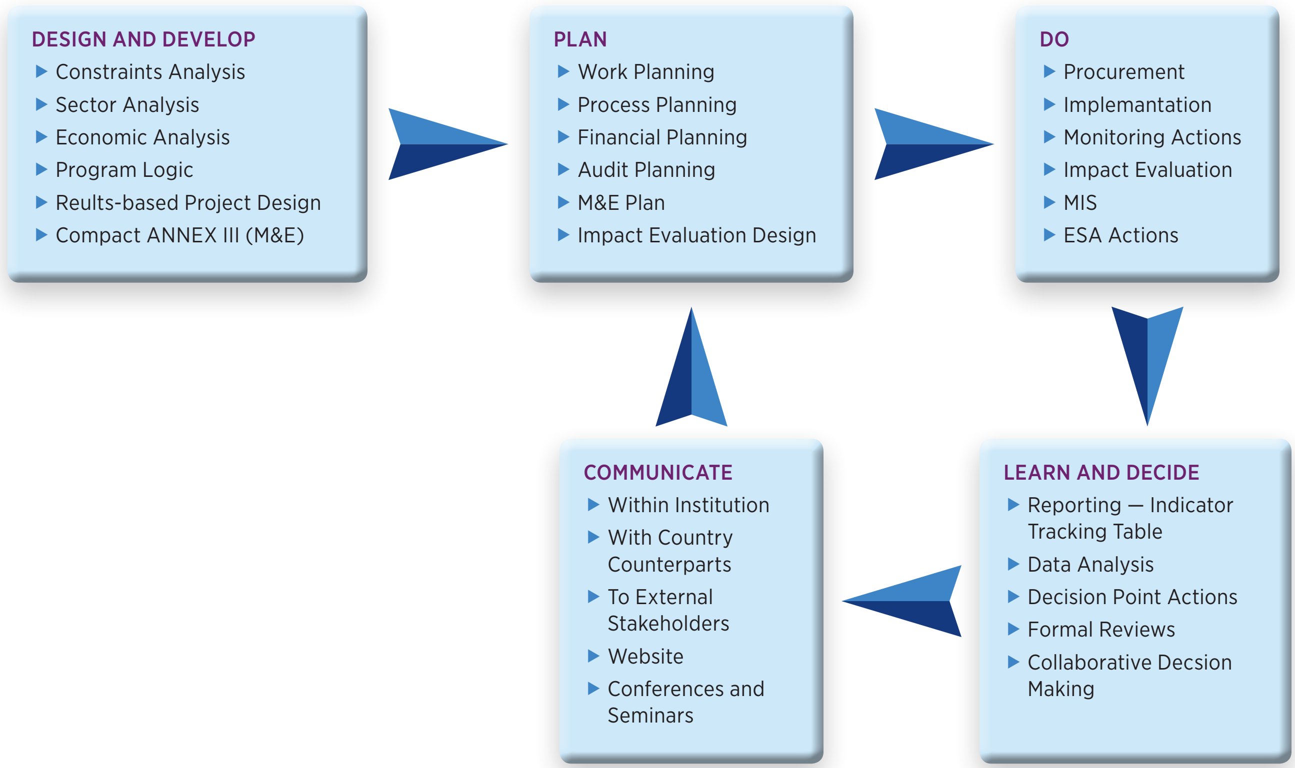

Figure 2. Integrating M&E in Compact Operations

quarterly to assess whether results are being achieved and subsequently integrates this information into project management decisions. Data for performance monitoring and reporting comes from baseline and follow-up surveys, project implementers, and other entities.

MCC strongly supports comprehensive, quality data collection conducted by local resources and frequently uses M&E program funds to invest in surveys fielded by both private firms and national statistical agencies or other government entities. All collected data, whether from surveys or implementers, undergo regular quality checks monitored by MCC to ensure integrity and accuracy.

Evaluating Program Performance and Results

MCC's development initiatives have helped reduce poverty, while spurring entrepreneurship and economic growth and helping to build more stable, accountable, and inclusive societies. MCC's investments in areas like infrastructure, water and sanitation, agriculture, education, and energy are expected to benefit about 175 million people around the world.

MCC aggregates results and program outputs in key sectors to measure progress in those areas across compacts. Currently, MCC calculates aggregate results and program outputs 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 periodically. MCC may complete early process-level indicators, such as contract dollars disbursed, more quickly than other indicators. The actual construction of a road, for example, will take more time and will be a more relevant indicator as time passes.

Table 4 presents MCC's program results across a representative set of select output indicators as of June 30, 2016, 2015, and 2014. The table aggregates country-specific output 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 the 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 on the results pages on its website (www .mcc.gov).

Post-Program Evaluations

MCC also conducts **performance** and **impact** evaluations to help evaluate the long-term results of its investments.

- **Performance evaluations** estimate the contribution of MCC investments to changes in trends on outcomes, including household income. Performance evaluations serve an accountability purpose by comparing changes between the situation both before and after the MCC investment.
- **Impact evaluations** are the most rigorous form of evaluations because they estimate the causal impact of the MCC investment on key outcome indicators. They make it possible to know whether the observed impacts were caused specifically by an MCC investment or were the result of external factors. Impact evaluations compare what happened with the investment to what would have happened without it through use of a counterfactual.

Country Selection Process

The MCC Board of Directors selects eligible countries for MCC assistance. Transparency regarding both the process and the criteria that govern and inform the selection of eligible country partners is a hallmark of the MCC model. For a country to be selected for an MCC assistance program, it must demonstrate commitment to just and democratic governance, investment in its people, and economic freedom as measured by a variety of policy indicators. MCC's Board of Directors examines this commitment primarily by consulting annual country "scorecards" of policy performance, as well as relevant supplemental information. It then considers the overall opportunity to reduce poverty and generate economic growth in a country, as well as the funding available.

MCC's selection process relies heavily on these public, data-driven country scorecards, which allow stakeholders, policy makers, Congress, taxpayers, and beneficiaries to hold the agency accountable for its decisions. Table 5 lists the policy indicators included in MCC's annual country scorecards.

MCC Effect

MCC's approach to selecting partners encourages countries—and not just MCC partner countries—to improve their economic and social policies before MCC invests a single dollar. This is sometimes called the "MCC Effect". MCC sees this when government and civil society groups contact MCC or indicator institutions to learn about and improve their scorecard performance.

A number of countries set up inter-ministerial committees to improve their scorecard performance and policy data. An independent global survey of development stakeholders found that they repeatedly identified MCC eligibility criteria as among the most influential external assessments of government performance. Many countries also regard their MCC scorecard performance as a stamp of approval that tells their citizens and the private sector that the country is well-governed.

Table 4. Program Results by Sector on Select Output Indicators for FYs 2016, 2015, and 2014

	Cumulative Target Through FY 2016	Actual			Performance on Targets[1]		
		June 30, 2016	June 30, 2015	June 30, 2014	June 30, 2016	June 30, 2015	June 30, 2014
Sector — Roads							
Indicator: Value of signed contracts for road work *(dollars in millions)*	$ 2,242	$ 2,345	$ 2,367	$ 2,355	105%	116%	110%
Indicator: Kilometers of roads under works contracts	3,904	3,918[2]	3,918	3,973	100%	100%	103%
Indicator: Kilometers of roads completed	3,551	2,876	2,876	2,444	81%	86%	64%
Countries Tracked: Armenia, Burkina Faso, Cabo Verde, El Salvador, Georgia, Ghana, Honduras, Mali, Moldova, Mongolia, Mozambique, Nicaragua, Philippines, Senegal, Tanzania, Vanuatu							
Sector — Agriculture and Irrigation							
Indicator: Hectares under new or improved irrigation	292,362	169,980	121,795	120,063	58%	42%	54%
Indicator: Value of agricultural and rural loans *(dollars in millions)*	$ 87	$ 87	$ 85[2]	$ 87	100%	97%	102%
Indicator: Farmers trained	236,402	275,335	274,442	120,063[3]	116%	116%	105%
Indicator: Enterprises assisted	3,564	4,223	4,203	4,137	118%	118%	114%
Countries Tracked: Armenia, Burkina Faso, Cabo Verde, El Salvador, Georgia, Ghana, Honduras, Indonesia, Madagascar, Mali, Moldova, Morocco, Mozambique, Namibia, Nicaragua, Senegal							
Sector — Water and Sanitation							
Indicator: Value of signed contracts for water and sanitation works *(dollars in millions)*	$ 777	$ 779	$ 590	$ 574	100%	116%	112%
Countries Tracked: Cabo Verde, El Salvador, Georgia, Ghana, Jordan, Lesotho, Mozambique, Tanzania, Zambia							
Sector — Education							
Indicator: Students participating	265,586	215,243	215,160[2]	228,847	81%	80%	99%
Indicator: Facilities completed	811	746	746	745[3]	92%	82%	99%
Indicator: Value of signed contracts for construction and/or equipping of educational facilities *(dollars in millions)*	$ 187	$ 187	$ 180	$ 118	100%	82%	101%
Countries Tracked: Burkina Faso, El Salvador, Georgia, Ghana, Mongolia, Morocco, Namibia							
Sector — Land							
Indicator: Stakeholders trained	27,329	73,321	73,211[2]	99,059	268%	270%	105%
Indicator: Land administration offices established	280	384	393	249	137%	158%	NA
Countries Tracked: Benin, Burkina Faso, Cabo Verde II, Ghana, Lesotho, Madagascar, Mali, Mongolia, Mozambique, Namibia, Nicaragua, Senegal							

[1] *Based on the cumulative target for that year.*

[2] *Data declined due to corrections of misreported data in closed compacts.*

[3] *Data declined due to M&E Plan revision or data revision by MCA unit.*

Table 5: MCC Selection Criteria

Ruling Justly	Investing In People	Encouraging Economic Freedom
Civil Liberties	Immunization Rates	Land Rights and Access
Political Rights	Health Expenditures	Trade Policy
Control of Corruption	Primary Education Expenditure	Regulatory Quality
Government Effectiveness	Girls' Primary Education Completion	Inflation
Rule of Law	Natural Resource Protection	Fiscal Policy
Freedom of Information	Child Health	Access to Credit
		Business Start-up
		Gender in the Economy

Compact Development, Implementation, and Closure

Countries seeking to sign a compact with MCC must first be selected as compact eligible by MCC's Board of Directors based on the process described above and the indicator criteria identified in Table 5. Several principles are key to ensuring countries develop successful compact proposals. Eligible countries should demonstrate **country ownership and commitment** by providing leadership, mobilizing resources, and engaging broad groups of stakeholders and potential beneficiaries throughout the compact development process. Countries should directly address constraints to **economic growth,** even when doing so may involve difficult public policy decisions. Compact programs should be based upon **strong program logic** that clearly ties proposed projects to measurable results and **high economic returns,** as demonstrated in increased incomes for beneficiaries. Well-developed compact programs also have **manageable technical, financial, environmental, and social risks** and allow for **timely implementation** within a fixed, five-year term, given each country's own oversight and management capacities.

To develop a compact program, eligible countries typically follow a process that includes five phases. During Phase One, the country works closely with MCC on a preliminary analysis of the constraints to its economic growth and poverty reduction. During Phase Two, the country identifies the root causes behind the most binding constraints, establishes clear program objectives, and begins to develop program logic. In Phase Three, the country proposes specific investment projects to address one or more of the binding constraints and achieve program objectives. The most promising projects are further developed and appraised during Phase Four. MCC and the country agree on the terms of the proposed program, sign the compact agreement, and prepare for the compact to enter into force. Once a compact enters into force, the fixed five-year implementation period begins.

Compact implementation is governed by the terms and conditions of each compact and its program implementation agreement, as well as MCC policies and guidelines. The compact generally includes a description of the program, including all projects, activities, and their associated objectives; the overall grant amount, project allocations, and a multi-year financial plan for the program; the obligations and responsibilities of the partner country, including any conditions precedent to the disbursement of compact funding; implementation and oversight structure and responsibilities, including designation of the partner country's accountable entity (also referred to as a MCA) as responsible for program administration, and oversight; a description of the M&E approach, including a summary of indicators and related targets; and all required MCC approvals and associated fiscal and procurement controls.

MCC also maintains guidance to ensure the orderly and efficient closure of compacts at the end of their five-year term. The close-out process starts with the development of a concise program closure plan by the partner country's accountable entity, which describes the closure strategy for each project and activity, the wind-up or continuation of the accountable entity, and other important aspects required to close out program activities as detailed in MCC's Program Closure Guidelines. While the content of such closure plans varies by country, project, and activity, all plans must include the components outlined in MCC's guidelines and must be approved by MCC. All compact programs formally close 120 days following the final day of the compact's five-year term.

Looking Forward

New Compacts and Threshold Programs

MCC and the Government of Liberia signed a $257 million compact in October 2015. The five-year compact with Liberia combines infrastructure investments with policy and institutional reforms designed to modernize the country's power sector and strengthen its road maintenance systems. MCC's investment complements USG efforts to help Liberia recover from the Ebola outbreak, significantly enhances the USG Power Africa engagement in Liberia, and supports two sectors critical for broad growth.

In November 2015, MCC and the Government of Sierra Leone signed a $44.4 million threshold program. MCC's investment in Sierra Leone will support policy reforms and improved governance in the water and electricity sectors. This program will create a foundation for delivery of financially sustainable water and electricity by establishing independent regulation, strengthening key institutions, and increasing transparency and accountability.

At its quarterly meeting on December 16, 2015, the Board of Directors selected Côte d'Ivoire, Kosovo, and Senegal as eligible for compacts, as well as Sri Lanka and Togo as eligible for threshold programs. Three of the five countries (Kosovo, Sri Lanka, and Togo) are new partners for MCC. After making progress on democratic rights, Kosovo passed MCC's scorecard for the first time in FY 2016. Cote d'Ivoire, which was selected in December 2014 for a threshold program, transitioned into the compact program after showing continued improvement on its scorecard and achieving greater political stability. Senegal successfully completed its first MCC compact in September 2015 and demonstrated improved scorecard performance over the life of the partnership. MCC's Board of Directors also instructed the agency to explore possible opportunities for future regional investments in both Cote d'Ivoire and Senegal.

The MCC Board of Directors approved the first compact with the Republic of Niger in June 2016. The $437 million Sustainable Water and Agriculture Compact will strengthen Niger's agricultural sector by improving water availability, roads and market access, and has the potential to benefit more than 3.9 million people. The compact also includes a significant investment to bolster the country's statistical capacity. Timely and accurate agricultural statistics play a critical role in assessing government policy, food security, and economic growth.

The $498 million Ghana Power Compact entered into force in September 2016. This milestone was achieved following the release of tender documents for private sector participation in the management of the Electricity Company of Ghana, which was a condition for the compact moving forward. The five-year Ghana Power Compact supports the Government of Ghana in creating a financially viable power sector that meets the current and future needs of Ghanaian households and businesses, ultimately helping reduce poverty across the country.

Looking forward to FY 2017, MCC expects to bring two compacts (Nepal and Côte d'Ivoire) to the Board of Directors for approval.

Data

MCC is examining how the data revolution is changing our operational needs and how it could be harnessed to achieve greater impact and sustainability of our programs. MCC completed a geospatial needs assessment and subsequently proposed a strategy to enable more effective and consistent use of geospatial data in our programs. MCC is also analyzing how mobile phones, access to the internet, digital infrastructure, and associated policies could be more appropriately captured in MCC's model to catalyze economic growth and help people lift themselves out of poverty.

MCC is also testing approaches to incorporate greater data usage at the country level, as well as to increase the value of collected data by training our staff on data analytics and open data. Similarly, MCC has partnered with the President's Emergency Plan for AIDS Relief (PEPFAR) to invest in a project known as the Data Collaboratives for Local Impact. This project will improve existing data and make it more accessible, strengthen data analysis and visualization, enhance opportunities for citizen contribution to data, cultivate talent, and ensure mutual accountability when implementing development aid so we can make a sustainable difference.

MCC continues to be a leader in the creation and use of rigorous, data-driven evaluations, as well as the sharing of best practices and lessons learned. During FY 2016, MCC convened an Evidence Workshop to share evaluation data and review lessons learned from the first El Salvador compact, examine evaluations from other development organizations, and link best practices to public policy.

Partnerships

As highlighted in the United Nations Sustainable Development Goals and MCC's *NEXT* strategy, the development landscape has changed significantly since MCC was founded. MCC must continue to seek and build strong partnerships with other civil society, public, and private sectors in order to have a long-lasting impact. Building on MCC's strong track record, our ambition is to more fully leverage partnerships to increase the scale and impact of our compacts.

In mid-2016, MCC announced the launch of the Office of Strategic Partnerships to help achieve this goal. As the range of potential partners creates new opportunities, it also creates a demand for a focused approach and specialized skill sets within MCC. This will allow MCC to better seize opportunities to ensure that we reach compact and threshold investment goals, enhance impact and sustainability of our work, and augment MCC's principles and presence as an essential institution within the USG.

On October 13, 2016, MCC hosted the first meeting of the newly formed MCC Advisory Council which was established under the Federal Advisory Committee Act. The council is comprised of 25 individuals from across the private sector with diverse technical expertise in infrastructure, information and communications technology, manufacturing, finance, and sustainable development. Council members also have specific expertise in MCC's partner countries. The council is charged with providing MCC operational advice and insight on innovations in infrastructure, technology, and sustainability; perceived risks and opportunities in MCC partner countries; and new financing mechanisms.

MCC's next partnership venture will be a new level of collaboration with the Organization for Economic Cooperation and Development to catalyze investment in MCC partner countries. This will enable MCC to leverage our constraints analyses to attract new public and private donors. These new donors would tackle constraints identified as most binding to growth, invest in projects that exceed MCC funding capabilities, and better utilize our distinct implementation model. If successful, we will improve transparency and learning during our compact development process and mobilize complementary co-investments with our partner countries.

Potential Upper Middle Income Level Graduation

In FY 2016, MCC's Board of Directors established a higher bar for assessing compact eligibility for countries that may transition to upper middle income status in future years. This higher bar requires the Board to examine additional data and information related to whether the country faces significant challenges accessing other sources of development financing, the nature of poverty in the country, particularly strong policy performance, and the willingness and ability of such countries to contribute resources to a potential compact. The specific factors are outlined in detail in MCC's FY 2017 Selection Criteria and Methodology Report and will be applied going forward, but overall these factors ensure that MCC remains faithful to its evidence-based country selection process and its mission to reduce poverty through economic growth in relatively well-governed, impoverished countries.

Analysis of MCC's Financial Statements

Financial Discussion and Analysis

At the end of FY 2016, MCC prepared four basic financial statements with accompanying notes and presented them to the USAID OIG for audit by an independent accounting firm. The Financial Section of this report contains the financial statements and notes, and the auditor's 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 (SBR).

Balance Sheet

The Balance Sheet is a representation of MCC's financial condition at the end of the FY. It shows the resources available to meet its statutory requirements (assets); the amounts it owes that will require payment from available resources (liabilities); and the difference between assets and liabilities (MCC's net position).

Assets

As of September 30, 2016, MCC held total assets of $4.9 billion, an increase of 7 percent from $4.6 billion reported in FY 2015. The majority of MCC's assets (98 percent) are held in its Fund Balance with Treasury (FBwT), which increased by $185 million due to differences in Appropriations Received and Gross Outlays. Gross Outlays decreased primarily due to the large number of compacts that are in the startup/development phase or have been completed in FY 2016.

Other assets, which reflect only 2 percent of MCC's total assets, include Advances, Property, Plant and Equipment (PP&E), and Accounts Receivable. Advances (Public) increased by $21 million primarily attributable to Malawi, Indonesia, and Zambia with investments in the middle of their compact life-cycle and the associated large works projects are in full execution phase. Advances (Intragovernmental) increased by $7 million due primarily to intragovernmental advances with the Department of Transportation for the countries of Liberia, Nepal, Philippines, Cote d'Ivoire, and Guatemala, the Department of Treasury (Office of

Technical Assistance) for the countries of Guatemala and Honduras and USAID for the country of Morocco.

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 capitalize its leases. Further, MCC has set capitalization thresholds at $200 thousand for IT equipment and internal use software, and $50 thousand for other fixed assets. MCC relocated its headquarter to Franklin Court in December 2015, and as of September 30, 2016, has capitalized $11 million in General Property, Plant and Equipment related to Leasehold Improvements such as build-out, engineering, construction, and furniture costs.

Liabilities

As of September 30, 2016, MCC had $79 million in liabilities, which represents amounts owed to grantees, vendors, contractors, trading partners, and employees. Grant liabilities comprise more than $58 million, or nearly 73 percent of MCC's total liabilities. Grant liabilities and retentions decreased by $57 million and $26 million, respectively, primarily due to compact closures in Philippines, Moldova, and Senegal.

Net Position

MCC's overall net position as of September 30, 2016, was $4.8 billion, an increase of $300 million, nearly 7 percent, from FY 2015. The available appropriations reported in MCC's positive net position represent the resources necessary to fund future compacts.

Statement of Net Cost

This statement shows MCC's net cost of operations by major program or appropriation fund categories. Table 6 describes each program.

During FY 2016, MCC incurred $603 million in net program costs, allocated among MCC's six active programs. Table 7 shows the percentage of FY 2016 net costs by program. Net program costs decreased by $176 million, or 23 percent, from FY 2015 due to a net decrease in compact program costs.

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, 2016, was $4.8 billion, an increase of $300 million from September 30, 2015. Net position is affected by changes to its two components: Cumulative Results of Operations and Unexpended Appropriations. As of September 30, 2016, Cumulative Results of Operations amounted to $2.5 million, an increase of $6.5 million from September 30, 2015. This balance is the cumulative difference, for all previous FYs, between funds available to MCC from all financing sources and the net costs incurred. The second component of net position, Total Unexpended Appropriations, amounted to $4.8 billion, an increase of $294 million, 7 percent, from FY 2015. This increase in Unexpended Appropriations was primarily due to the Liberia Compact obligation in December 2015 and the Philippines Compact closure in May 2016.

Statement of Budgetary Resources

This statement and related disclosures provide information about how budgetary resources were made available as well as their status at the end of the period. It is the only financial statement derived predominantly from the entity's budgetary general ledger in accordance with Federal accounting rules. The SBR 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, 2016.

For FY 2016, MCC had total budgetary resources of $3.3 billion, an increase of $519 million, or 18 percent, from FY 2015. Budgetary resources of $901 million were provided through FY 2016 Congressional appropriations and $2.3 billion were carried forward from appropriations in FY 2015 and prior years.

Table 6. MCC Fund Categories

Fund	Source and Purpose
Compact	Funds approved by Congress, apportioned by OMB, and obligated by MCC to cover compacts between MCC and partner countries. Note: Under authority contained in section 609(g) of the MCC Act, MCC provides Compact Implementation Funds (CIF) when it signs a compact to speed compact implementation by the partner country. OMB apportions grant funds for grants and cooperative agreements.
609(g)	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.
614(g)	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 MCC 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	Funds appropriated by Congress, apportioned by OMB, and used by MCC to help countries become eligible for MCC compact assistance.
Due Diligence	Funds apportioned by OMB and used by MCC to cover costs associated with assessing compact proposal 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.

Table 7. MCC Net Program Costs (Dollars in Thousands)

Program	FY 2016	FY 2015	% Change	Reason for Change
Compact	$ 428,348	$ 620,734	–31%	The $192 million decrease was the result of the number of compacts in the start up/development phase and the closures of the Philippines, Moldova, and Senegal Compacts.
609(g)	11,214	13,507	–17%	The $2.3 million decrease was primarily the result of decreases in expenses for the country of Ghana as it entered into Compact Implementation.
Threshold	3,776	2,108	79%	The $1.7 million increase was primarily the result of increases in expenses for the countries of Honduras, Sierra Leone, and Guatemala.
Due Diligence	47,278	39,730	19%	The $7.5 million increase was primarily due to an increase in program costs for Due Diligence Consultants and Personal Services Contracts.
Audit	3,369	3,722	–9%	The $353 thousand decrease was due primarily to a decrease in External Contract expenses incurred by the United States Agency for International Development (USAID) Office of Inspector General (OIG) and decreased OIG Rent Expenses resulting from the relocation of MCC headquarters to Franklin Court in Washington, DC.
Administrative	108,714	98,816	10%	The $9.9 million increase was primarily due to increases in operating/program expenses for IT/Non-Accounting and Finance contracted services and miscellaneous services.
TOTAL	**$ 602,699**	**$ 778,617**		

Analysis of MCC's Systems, Controls, and Legal Compliance

Systems

MCC has no plans to operate its own financial systems and plans to continue to utilize service providers.

Currently, the Department of the Interior's Interior Business Center (IBC) is MCC's financial management shared services provider for financial and payroll systems. MCC is responsible for overseeing the work that is done for MCC by 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 Statement of Assurance and the annual Statement of Assurance of Management Control over Financial Reporting submitted by MCC's service provider follow this section.

On an annual basis, 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 Enterprise Risk Management and Internal Control,* as well as the associated guidelines issued by the CFO Council. OMB Circular No. A-123, Appendix A, "Internal Control over 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 reporting. Appendix A allows for modified implementation to fit the circumstances, conditions, and structure of each entity. During FY 2016, MCC continued its efforts to reassess, improve, and enhance its financial, systems, program, and performance information.

FY 2016 Assurance Statement from CEO November 2, 2016

The Millennium Challenge Corporation's (MCC) 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 its internal controls 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 Enterprise Risk Management (ERM) and Internal Control.

Reporting Pursuant to FMFIA Section 2

Overall Statement of Assurance

Based on the results of its evaluation, MCC can provide unmodified reasonable assurance that its overall internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2016, was operating effectively.

Statement of Assurance for Internal Control Over Financial Reporting

In accordance with Appendix A of OMB Circular A-123, MCC conducted its assessment of the effectiveness of internal control over financial reporting, which included the safeguarding of assets and compliance with applicable laws and regulations. Based on the results of this assessment, we can provide unmodified reasonable assurance that MCC's internal control over financial reporting was operating effectively as of September 30, 2016. The assessment did not identify any material weaknesses in the design or operation of the controls.

Reporting Pursuant to FMFIA Section 4

The Federal Financial Management Improvement Act of 1996 (FFMIA) was designed to advance federal financial management by ensuring that federal financial management systems provide accurate, reliable, and timely financial management information to the government's managers. Compliance with the FFMIA provides the basis for the continuing use of reliable financial management information by program managers, as well as by the President, Congress, and the public. The FFMIA requires agencies to have financial management systems that comply substantially with federal financial management system requirements, applicable federal accounting standards, and the application of the U.S. Government Standard General Ledger (USSGL) at the transaction level.

The vulnerability of MCC programs and systems was assessed in accordance with FMFIA and OMB guidance. Based on the results of the OMB Circular A-123, Appendix A and Appendix D assessments, MCC has determined that our financial management systems are in substantial conformance with the Section 4 (Financial Systems) requirements of FMFIA as of September 30, 2016.

Sincerely,

Dana J. Hyde
Chief Executive Officer
Millennium Challenge Corporation

FY 2016 Statement of Assurance 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

October 1, 2016

Dear Valued Customer:

The purpose of this letter is to provide assurance that the Oracle Federal Financial application controls remained unchanged for the period July 1, 2016, through September 30, 2016.

You were previously notified that KPMG LLP examined the description of the Oracle Federal 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, 2015, through June 30, 2016. A softcopy version of the report was provided to you mid-July 2016.

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, 2016. 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 Federal Financial application controls at the IBC for the period July 1, 2016, through September 30, 2016. 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, 2016, did not change for the period of July 1, 2016, through September 30, 2016. The description of controls in the FY 2016 SSAE 16 examination report presents fairly the aspects of IBC controls that were in place as of September 30, 2016.

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, 2016. 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, 2016. As a result, the IBC continues to assert substantial compliance with financial accounting and reporting controls in place from July 1, 2016, through September 30, 2016.

If you have any questions on this assurance statement, please contact Dean N. Martin, Chief Enterprise Risk Manager, Dean_N_Martin@ibc.doi.gov or 303-969-5195.

Sincerely,

Donna L. Edsall, CPA Associate Director
Financial Management Directorate Interior Business Center

Other Management Information, Initiatives and Issues

The Independent Auditor's Report identified three significant deficiencies in internal control over financial reporting for the FY ending September 30, 2016. These deficiencies are:

1. Control over grant accrual estimates and validation.
2. Uncorrected misstatements in the Statement of Budgetary Resources.
3. Inadequate funds control system.

MCC will continue to enhance its internal controls to address the noted deficiencies. Specific enhancements in FY 2017 will include:

- Developing improved methods for posting accounting transactions (i.e., grant accruals).
- Continuing to improve budgetary procedures and budgetary reporting and management processes.
- Continuing to improve procedures to review transactions that are not routinely prepared in its operations.

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 latter 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 for all payments subject to the Prompt Payment Final Rule. In FY 2016, MCC's prompt payment performance was 99 percent. MCC is taking steps to reduce the likelihood of future unnecessary interest payments.

Improper Payments Information Act (as amended by Improper Payments Elimination and Recovery Act of 2010 [IPERA] and the Improper Payments Elimination and Recovery Improvement Act [IPERIA] of 2012)

The Other Information section of this report contains MCC's IPIA 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 all 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. Additionally, MCC did not conduct payment recapture audits because the agency determined it is not cost effective based on past improper payment rates and amounts. OMB concurred with this conclusion.

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 2016, MCC had no debt to refer to the Department of the Treasury.

Federal Information Security Management Act (FISMA) of 2002 (as amended by Federal Information Security Modernization Act of 2014)

In FY 2016, MCC relocated its IT services to its new Headquarters at Franklin Court, Washington, DC. MCC leveraged the relocation to provide greater network capacity, enhanced IT security services, and system upgrades to improve the confidentiality and integrity of MCC data. To support the relocation, MCC conducted a full security assessment and accreditation of its local area network in compliance with internal, FISMA, and OMB policy and requirements. MCC also instituted a software data management solution and a software assurance system that reduces data breach exposure and increases response capability to potential malicious activity.

Privacy Act of 1974

MCC continued to strengthen its internal privacy controls in FY 2016 by delivering automated data management services designed to monitor and audit access to all personally identifiable information (PII) within MCC's IT systems. The system identifies and records access to MCC's PII resources and provides management an automated alerting mechanism. The automation improved the information system's security controls by providing better data confidentiality and integrity. This was achieved through increased monitoring and automated alerting of MCC policy violations and potential data breaches.

Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of MCC, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with generally accepted accounting principles for Federal entities and the formats prescribed by OMB Circular A-136, 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 USG, a sovereign entity.

Financial Section

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

November 15, 2016

The mission of the Millennium Challenge Corporation (MCC) is to reduce poverty through economic growth. MCC stimulates economic development by carefully evaluating and selecting partner countries for strategic investments. Once a partner country is selected, MCC utilizes a risk-based investment approach that integrates a country ownership model with continuous oversight, ensuring we meet our fixed budget and schedule on all projects. This proven model allows us to focus our efforts on MCC's guiding principles: good governance, economic freedom, and investing in people.

This fiscal year, MCC's Board of Directors approved two compacts and one new threshold program. This includes the first-ever compact signed with the Republic of Niger to boost their agricultural infrastructure. MCC also reached a significant milestone when the Ghana Power Compact entered into force this year, marking MCC's largest investment in the Power Africa initiative. Since inception, MCC's cumulative investment exceeds $10 billion and includes 33 compacts and 26 threshold programs. During FY 2016, we obligated $687 million and disbursed $538 million in support of 13 active compacts.

Congress continues to prioritize transparency in global assistance, as evidenced by the recently passed Foreign Aid Transparency and Accountability Act. MCC was ranked first in the U.S. Government, and second worldwide for foreign aid transparency by the 2016 Aid Transparency Index. As further evidence of our commitment to transparency and accountability in our operation, for the second year in a row, MCC has obtained an unmodified opinion and no material weakness in our Annual Financial Statements. These accomplishments, among others, drive our continued efforts to maximize internal efficiencies, as defined in the *NEXT* strategy. Our highly skilled staff is vital to this goal and as such MCC is focused on human capital development in our quest for excellence in financial management and effective delivery of foreign aid.

The stewardship of American tax dollars is paramount to our global mission. As demonstrated by our 2016 ranking, we are committed to transparent investments with measurable results. MCC's continuous improvement in the delivery of foreign assistance is validated by its unmodified opinion on the FY 2016 financial statements. We continue to strategically leverage existing systems, as well as shared service providers, to ensure we maintain a secure and reliable control environment. This is a key component of MCC's effective internal control framework.

Our FY 2016 independent financial statements audit report identifies three significant deficiencies and related recommendations to which MCC has concurred. We do not foresee any major impediments to correcting these deficiencies and expect complete remediation no later than September 30, 2017. We have made significant progress in addressing four recommendations related to three significant deficiencies identified in our FY 2015 independent financial statements audit report. We have closed three recommendations and expect to close the last recommendation no later than March 31, 2017.

In FY 2017, we look forward to using our robust risk-based approach to investment management to formalize and implement a cross-functional Enterprise Risk Management (ERM) program that is integrated with our internal controls and existing risk management program. As prescribed by OMB's Circular A-123 Update, our integrated internal control and ERM framework will enhance MCC's ability to effectively identify, prioritize, and manage both operational and strategic risks. Once implemented, our ERM program will strengthen decision-making and promote mission success.

Mahmoud Bah
Acting Vice President and Chief Financial Officer
Department of Administration and Finance

Financial Statements

The principal financial statements have been prepared to report the financial position and the results of operations of 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 October 7, 2016). The financial statements should be read with the understanding that they are for a component of the USG, a sovereign entity. Liquidation of such liabilities requires enactment of an appropriation. Comparative data for September 30, 2015 and September 30, 2016 has been included. MCC is presenting the following financial statements, notes to the financial statements, and independent auditor's report:

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

Note that totals may vary slightly due to rounding.

Balance Sheet

As of September 30, 2016 and September 30, 2015 (in thousands)		
Assets	**FY 2016**	**FY 2015**
Intragovernmental:		
Fund Balance with Treasury *(Note 2)*	$ 4,785,540	$ 4,600,318
Advances *(Note 3)*	9,651	2,941
Total Intragovernmental	**4,795,191**	**4,603,259**
Accounts Receivable, Net *(Note 4)*	470	1
General Property, Plant, and Equipment, Net *(Note 5)*	11,147	—
Advances *(Note 3)*	62,026	41,375
Total Assets	**$ 4,868,834**	**$ 4,644,635**
Liabilities		
Intragovernmental:		
Accounts Payable	$ 617	$ 1,520
Other Liabilities	455	288
Total Intragovernmental	**1,072**	**1,808**
Accounts Payable	7,979	5,928
Accrual — Grant Liabilities *(Note 7)*	58,614	141,687
Other Liabilities	10,884	5,397
Total Liabilities *(Note 9)*	**$ 78,549**	**$ 154,820**
Commitments and contingencies *(Note 8)*		
Net Position		
Unexpended Appropriations — All Other Funds	$ 4,787,823	$ 4,493,791
Cumulative Results of Operations — All Other Funds	2,462	(3,976)
Total Net Position	**$ 4,790,285**	**$ 4,489,815**
Total Liabilities and Net Position	**$ 4,868,834**	**$ 4,644,635**

The accompanying notes are an integral part of these statements.

Statement of Net Cost

For the Years Ended September 30, 2016 and September 30, 2015 (in thousands)		
Program Costs *(Note 11)*	**FY 2016**	**FY 2015**
Compact Program Costs	$ 428,348	$ 620,734
609 (g) Program Costs	11,214	13,507
Threshold Program Costs	3,776	2,108
Due Diligence Program Costs	47,278	39,730
Audit Costs	3,369	3,722
Administrative Costs	108,714	98,816
Net Cost of Operations	**$ 602,699**	**$ 778,617**

The accompanying notes are an integral part of these statements.

Statement of Changes in Net Position

For the Years Ended September 30, 2016 and September 30, 2015 (in thousands)	FY 2016	FY 2015
Cumulative Results of Operations:		
Beginning Balances	$ (3,976)	$ 876
Budgetary Financing Sources:		
Appropriations Used	606,968	771,486
Other Financing Sources:		
Donations and Forfeitures of Property *(Note 8)*	348	455
Imputed Financing	1,821	1,824
Total Financing Sources	**609,137**	**773,765**
Net Cost of Operations	**(602,699)**	**(778,617)**
Net Change	**6,438**	**(4,852)**
Cumulative Results of Operations	**2,462**	**(3,976)**
Unexpended Appropriations:		
Beginning Balance	4,493,791	4,365,777
Budgetary Financing Sources:		
Appropriations Received	901,000	899,500
Appropriations Used	(606,968)	(771,486)
Total Budgetary Financing Sources	**294,032**	**128,014**
Total Unexpended Appropriations	**4,787,823**	**4,493,791**
Net Position	**$ 4,790,285**	**$ 4,489,815**

The accompanying notes are an integral part of these statements.

Combined Statement of Budgetary Resources

For the Years Ended September 30, 2016 and September 30, 2015 (in thousands)	FY 2016	FY 2015
Budgetary Resources:		
Unobligated Balance Brought Forward, October 1	$ 2,311,459	$ 1,839,461
Recoveries of Prior Year Unpaid Obligations	85,915	40,472
Unobligated balance from Prior Year Budget Authority, Net	2,397,374	1,879,933
Appropriations	901,000	899,500
Total Budgetary Resources	**$ 3,298,374**	**$ 2,779,433**
Status of Budgetary Resources:		
New Obligations and Upward Adjustments (Total)	$ 1,039,792	$ 467,974
Unobligated Balance, End of Year:		
Apportioned, unexpired accounts	2,225,327	2,272,687
Unapportioned, unexpired accounts	33,255	38,722
Unexpired unobligated balance, end of year	2,258,582	2,311,459
Unobligated Balance, End of Year (Total)	2,258,582	2,311,459
Total Budgetary Resources	**$ 3,298,374**	**$ 2,779,433**
Change in Obligated Balance:		
Unpaid obligations:		
Unpaid obligations, brought forward, October 1	$ 2,288,851	$ 2,586,949
New obligations and upward adjustments	1,039,792	467,974
Outlays (gross)	(715,779)	(725,600)
Recoveries of prior year unpaid obligations	(85,915)	(40,472)
Unpaid obligations, end of year	**$ 2,526,949**	**$ 2,288,851**
Memorandum entries:		
Obligated Balance, Start of Year	**$ 2,288,851**	**$ 2,586,949**
Obligated Balance, End of Year	**$ 2,526,949**	**$ 2,288,851**
Budget Authority and Outlays, Net:		
Budget Authority, Gross	$ 901,000	$ 899,500
Budget Authority, Net (Total)	**$ 901,000**	**$ 899,500**
Outlays, Gross	$ 715,779	$ 725,600
Outlays, Net (Total)	**$ 715,779**	**$ 725,600**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

(As of September 30, 2016 and September 30, 2015)

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 (PL) 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, five-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 USAID 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 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*, as amended. FASAB is recognized by the American Institute of Certified Public Accountants as the official accounting standards-setting body for USG 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 CFO Act of 1990, the Government Management Reform Act of 1994, and the Government Corporation Control Act (31 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.

Pursuant to OMB Circular A-136, the format of the Statement of Budgetary Resources (SBR) was revised in FY 2016 to better align with the United States Department of Treasury (Treasury) Standard Form (SF) 133. Additionally, the presentation of the Status of Budgetary Resources section in the FY 2016 SBR was also modified. Accordingly, certain reclassifications were made to the previously issued FY 2015 SBR to conform to the new presentation format.

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 assets and 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. The assumptions made and estimates used by MCC Management to prepare the financial statements are based upon the facts that exist when the statements are prepared, and on various other assumptions that are believed to be reasonable under the circumstances. Changes in estimates are reflected in the period in which they become known. Actual results may differ from those estimates. The Notes to the Financial Statements include information to assist the reader in understanding the effect of changes in assumptions on the related information.

The most significant estimates are a result of the accrued expenses recorded by MCC for grant liability incurred by MCAs. The majority of those liabilities are related to large infrastructure project and quantity estimates made on works performed but not yet invoiced as of the end of the FY. Due to the nature of the infrastructure contracts, the variability in quantities estimated or projected may differ from actual quantities billed through interim or final invoicing.

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 FY 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. Accrual — Grant Liabilities

Grant accrual liabilities represent the carrying value of obligations assumed by MCC for works, goods, and services performed/rendered/delivered but not yet invoiced through the Balance Sheet date. MCC's partner countries, through their respective accountable entities, are allocated a spending authority on a quarterly basis. A spending authority for a given period is the portion of the compact that MCC authorized, approved, and made available to MCAs for current and past works, goods, and services incurred/delivered/received and for which MCAs can request disbursement in a given quarter. Unused spending authority is the difference between the authorized and approved spending authority and the actual disbursements in a given period.

MCC's grant accrual methodology assumes that "unused spending authority" in a given period represents the upper limit of the accrual calculation and that invoices on hand at the end of a given period (MCA in-house invoices) represents the lower limit of the accrual calculation. In arriving at a reasonable estimate of the MCAs' accrued liabilities using information available at the time of the calculation, MCC discounts the unused spending authority by using a rolling average of actual disbursements to calculate the grant accrual liabilities. When better information is available from MCAs on accrued liabilities, MCC relies on such information in arriving at the best estimate.

MCA large infrastructure projects are structured to include retentions on invoices. The contract retentions represent a percentage of invoice amounts retained by the MCAs as a guarantee for completion of works contractually agreed upon. The contract retentions are for works completed and, as such, are owed to the contractor contingent upon the fulfillment of specific requirements stipulated in the relevant contracts. MCAs do not release the retentions or request MCC payment for the retentions until the MCAs have verified the contractor has met all the requirements and obligations under the contract. MCC recognizes MCA contract retentions as part of the grant accrual liabilities.

G. 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 FBWT represent no-year funds maintained in appropriated accounts. MCC's records are reconciled with those of Treasury on a monthly basis.

H. Advances

MCC makes funding available to Federal agencies, MCAs, and local vendors. Federal agencies are funded through IAAs. MCAs are funded either directly through a local bank account called the permitted account, or indirectly through vendor advance payments in accordance with the compact agreement. The provision of such funding is mainly to address cash flow flexibility for operating and administrative cost, to leverage better foreign exchange translation for the MCAs, or to meet contractual requirements of MCAs such as mobilization of equipment on large infrastructure projects. MCC records advances as assets. The advances are liquidated or amortized as follows: the funding made available to MCAs through the local permitted account is tracked and liquidated on a monthly basis based on Monthly Commitments and Disbursements Reports provided by the MCAs to MCC. The funding advanced to contractors or vendors (mobilization advances) is amortized based on contractual agreed upon schedules.

I. Accounts Receivable, Net

Accounts receivable reflect overpayments of payroll, travel, and other MCC current and former employee expenses. Accounts receivable also reflect disallowed and sustained 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 PP&E consists of capitalized general equipment costs. MCC's capitalization threshold is $50,000 for all assets, except for IT equipment and internal use software, 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 and furniture are depreciated using the straight-line method of depreciation over the estimated useful lives of the improvements (usually between eight and ten years). All other general PP&E is depreciated using the straight-line method over an estimated useful life of five 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, 2016. 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 PL 99-335. Pursuant to this law, most USG 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 one percent of the gross pay of employees covered by this system, match voluntary employee contributions up to three percent of the employees' gross pay, and match one-half of contributions between three and five percent of the employees' gross pay, for a maximum MCC contribution of five 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 seven percent of their gross pay toward their retirement benefits. A matching contribution of seven 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 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. Liabilities Not Covered by Budgetary Resources

As of September 30, 2016, and September 30, 2015, budgetary resources have not yet been made available to fund certain liabilities reported on the Balance Sheet. Liabilities not covered by budgetary resources represent amounts for which congressional appropriation is required and funding is generally made available in the year payments are due or anticipated. Liabilities not covered by budgetary resources include the Judgment Fund, unfunded leave, Federal Employees Compensation Act (FECA), unemployment compensation, and unamortized rent abatement liability.

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.

Unfunded 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.

Unfunded Federal Employees Compensation Act

The FECA (established by PL 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 liability for workers' compensation includes any costs incurred but unbilled as of year-end, as calculated by DOL, and not funded by current appropriations.

Unfunded Unemployment

DOL's unemployment programs provide unemployment benefits to eligible workers who become unemployed through no fault of their own, and meet certain other eligibility requirements. The Unemployment Compensation for Federal Employees program provides benefits for eligible, unemployed, former civilian Federal employees. MCC's liability for unemployment includes any costs incurred but unbilled as of year-end, as calculated by DOL, and not funded by current appropriations.

Unamortized Rent Abatement Liability

The rent abatement represents MCC's period of free rent awarded by the lessor of the Franklin Court building. MCC maintains a 10-year operating lease for office space at Franklin Court, on which lease payments commence in FY 2017. Per the terms of the contract, MCC was awarded approximately 15 months of rent abatement beginning on December 1, 2015. As a result of this 15 month rent abatement, and in accordance with the Financial Accounting Standards Board Accounting Standards Codification, *Leases (Topic 842),* MCC recorded a liability which will be repaid on a monthly basis utilizing a straight-line approach over the 10 year lease period.

O. 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.

P. Parent/Child Relationships with Other Federal Agencies

MCC is a party to allocation transfers with other Federal agencies as both a transferring (parent) entity and receiving (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. Per OMB guidance, child transfer activities are to be included and parent transfer activities are to be excluded in trial balances. MCC allocates funds as the parent to USAID.

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. MCC may receive allocation transfers as the child from PEPFAR, Office of the United States Global AIDS Coordinator.

Q. 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.

R. Foreign currency transactions

The functional currency of the agency is United States Dollars (USD) and these financial statements are presented in that currency. Each MCC compact's budget amount is fixed and denominated in USD. The financial execution of our compacts cannot exceed the total budgeted amount. Disbursements occurring in other currencies are translated into USD and recorded in USD. The MCAs bear all currency translation risk and, as such, MCC does not record any foreign translation gain or loss in its financial statements.

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, 2016 and September 30, 2015 (in thousands)

Fund Balances	2016	2015
General Funds	$ 4,785,540	$ 4,600,318
Total	**$ 4,785,540**	**$ 4,600,318**

The Status of FBWT 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 FYs
- **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, 2016 and September 30, 2015 (in thousands)

Status of Fund Balance with Treasury	2016	2015
Unobligated Balance		
Available	$ 2,225,327	$ 2,272,687
Unavailable	33,255	38,772
Obligated Balance not yet Disbursed	2,526,949	2,288,851
Non-Budgetary FBWT	9	8
Total	**$ 4,785,540**	**$ 4,600,318**

Note 3 — Advances

As of September 30, 2016, MCC reported intragovernmental advances totaling $9,651 thousand, and public advances totaling $62,026 thousand. As of September 30, 2015, the amounts reported were $2,941 thousand and $41,375 thousand, respectively. The increase of $20,651 thousand in public advances is driven primarily by large advances in Zambia, Malawi, and Indonesia offset by the liquidation of advances in closed compacts in Senegal and Philippines. The $6,710 thousand increase in intragovernmental advances is driven primarily by the addition of IAAs with the DOT, the Department of Treasury Office of Technical Assistance, and USAID.

Note 4 — Accounts Receivable, Net

Total receivables at September 30, 2016 and September 30, 2015 were $470 thousand and $1 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 Statement of Federal Financial Accounting Standards (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, 2016 (in thousands)	Estimated Useful Life	Cost	Accumulated Depreciation	Book Value
General PP&E				
Leasehold Improvements	10 years	$ 8,292	$ 566	$ 7,726
Furniture	10 years	3,597	291	3,306
Vehicles	5 years	177	62	115
Total		**$ 12,066**	**$ 919**	**$ 11,147**

Status of General Property, Plant, and Equipment, Net as of September 30, 2015 (in thousands)	Estimated Useful Life	Cost	Accumulated Depreciation	Book Value
General PP&E				
Leasehold Improvements	8–10 years	$ 10,924	$ 10,924	$ —
Vehicles	5 years	139	131	—
Total		**$ 11,063**	**$ 11,063**	**$ —**

Note 6 — Leases

MCC leases office space at the Franklin Court building in Washington, DC. The lease is an operating lease with a 10-year lease term with an effective date of December 1, 2015, and a termination date of November 30, 2025. The total Franklin Court lease is valued at $57,367 thousand with a termination liability in the amount of $18,015 thousand.

MCC also has short-term leases for one corporate vehicle (through September 13, 2020) and 20 copier machines (through December 31, 2017). The future lease payments due for the buildings and copier machines are depicted below.

Future Lease Payments Due — Equipment (in thousands)	Asset Category		
	Vehicle	Copier	Totals
FY 2017	$ 8	$ 65	$ 73
FY 2018	8	16	24
FY 2019	6	—	6
FY 2020	6	—	6
Total Future Lease Payments	**$ 28**	**$ 81**	**$ 109**

Future Lease Payments Due — Buildings — Franklin Court (in thousands)	Totals
FY 2017	$ 3,649
FY 2018	6,145
FY 2019	6,260
FY 2020	6,378
FY 2021	6,499
After FY 2021	28,436
Total Future Lease Payments	**$ 57,367**

Note 7 — Accrual - Grant Liabilities

In September 30, 2016 and September 30, 2015, MCC had grant liabilities of $58,614 thousand and $141,687 thousand, respectively. The $83,073 thousand decrease in grant liabilities was the result of changes in the compact portfolio in FY 2016.

Note 8 — Commitments and Contingencies

MCC's program execution results in commitments of future obligations with country-specific accountable entities. MCC and the accountable entity agree on the terms of the proposed program (compact/threshold), sign an agreement, and prepare for the agreement to enter into force. Once a compact/threshold enters into force, the obligation is recorded by MCC; until such time, MCC recognizes commitments for these accountable entities. As of September 30, 2016, MCC had commitments for the countries of Benin, Morocco, and Niger totaling $1,195,498 thousand. Similarly, as of September 30, 2015, MCC had commitments for the countries of Benin, Ghana, and Guatemala totaling $854,300 thousand which were obligated in FY 2016.

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. 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.

MCC is associated with one pending legal claim in the amount of $1,953 thousand for unpaid rent for a period of approximately five months for certain leased space at 1099 Franklin Court prior to MCC's effective occupancy date. An unfavorable outcome against the Federal Government is reasonably possible, but the General Services Administration will likely be responsible for any potential liability.

Note 9 — Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources at the end of the period totaled $9,154 thousand and $3,977 thousand as of September 30, 2016, and September 30, 2015, respectively.

Liabilities Not Covered by Budgetary Resources (in thousands)	2016	2015
Intragovernmental FECA	$ 82	$ —
Unemployment	9	3
Total Intragovernmental	91	3
Annual Leave Liability	4,112	3,974
Franklin Court Unamortized Rent Abatement	4,951	—
Total Liabilities Not Covered by Budgetary Resources	9,154	3,977
Total Liabilities Covered by Budgetary Resources	69,395	150,843
Total Liabilities	**$ 78,549**	**$ 154,820**

Note 10 — 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 $348 thousand for FY 2016 and $455 thousand for FY 2015.

Note 11 — Intragovernmental Costs

The table below illustrates the value of exchange transactions between MCC and other Federal (intragovernmental) entities, as well as Non-Federal (public) entities.

Intragovernmental Costs (in thousands)	2016	2015
Compact Programs		
Intragovernmental	$ 37	$ 1,242
Public	428,311	619,492
Total Compact Costs	**428,348**	**620,734**
609(g) Programs		
Intragovernmental	2,333	7,088
Public	8,881	6,419
Total 609(g) Costs	**11,214**	**13,507**
Threshold Programs		
Intragovernmental	1,130	1,138
Public	2,646	970
Total Threshold Costs	**3,776**	**2,108**
Due Diligence Programs		
Intragovernmental	5,179	5,609
Public	42,099	34,121
Total Due Diligence Costs	**42,278**	**39,730**
Audit Programs		
Intragovernmental	3,231	3,450
Public	138	272
Total Audit Costs	**3,369**	**3,722**
Administrative Programs		
Intragovernmental	25,165	22,602
Public	83,549	76,214
Total Administrative Costs	**108,714**	**98,816**
Total Program Costs	**$ 602,699**	**$ 778,617**

Note 12 — Undelivered Orders at the End of the Period

Undelivered Orders represent the amount of goods and/or services ordered to perform MCC's program activities, which have not been received. Undelivered orders at the end of the period totaled $2,529,225 thousand and $2,182,317 thousand as of September 30, 2016, and September 30, 2015, respectively.

Undelivered Orders at September 30, 2016 and September 30, 2015 (in thousands)		
Programs	2016	2015
Compact	$ 2,190,413	$ 1,931,860
609(g)	53,735	42,210
Threshold	86,439	18,208
Due Diligence	115,810	98,444
Audit	3,752	2,310
Administrative	79,076	89,285
Total	**$ 2,529,225**	**$ 2,182,317**

Note 13 — 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 2015 Statement of Budgetary Resources and the actual amounts reported for FY 2015 in the Budget of the Federal Government. Since the FY 2016 financial statements will be reported prior to the release of the Budget of the Federal Government, MCC is reporting for FY 2015 only. Typically, the Budget of the Federal Government with the FY 2016 actual data is published in February of the subsequent year. Once published, the FY 2016 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	$ 2,779	$ 468	$ 726
Deductions	—	—	1
Budget of the U.S. Government	**$ 2,779**	**$ 468**	**$ 725**

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

Note 14 — 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, 2016, and September 30, 2015, respectively. Total Resources Used to Finance Items Not Part of the Net Cost of Operations at the end of the period totaled negative $347,028 thousand and $343,979 thousand as of September 30, 2016, and September 30, 2015, 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, 2016 (in thousands)

Resources Used to Finance Activities		FY 2015 Reported Program Costs	
Budgetary Resources Obligated		Gross Costs	
New Obligations and Upward Adjustments	$ 1,039,792	Net Program Costs	$ 602,699
Recoveries of Prior Year Unpaid Obligations	(89,915)		
Other Financing Sources	2,169		
Total Resources Used to Finance Activities	956,046		
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(347,028)	Less: Earned Revenue	
Total Components of Net Cost of Operations that will Not Require or Generate Resources	(6,319)	Net Program Revenue	—
Net Cost of Operations per the Budget	**$ 602,699**	**Net Cost of Operations per the Statement of Net Cost**	**$ 602,699**

Reconciliation of Net Cost of Operations to Budget for the Year Ending September 30, 2015 (in thousands)

Resources Used to Finance Activities		FY 2015 Reported Program Costs	
Budgetary Resources Obligated		Gross Costs	
New Obligations and Upward Adjustments	$ 467,974	Net Program Costs	$ 778,617
Recoveries of Prior Year Unpaid Obligations	(40,472)		
Other Financing Sources	2,279		
Total Resources Used to Finance Activities	429,781		
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	343,979	Less: Earned Revenue	
Total Components of Net Cost of Operations that will Not Require or Generate Resources	4,857	Net Program Revenue	—
Net Cost of Operations per the Budget	**$ 778,617**	**Net Cost of Operations per the Statement of Net Cost**	**$ 778,617**

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, 2016, and 2015

AUDIT REPORT NO. M-000-17-001-C
NOVEMBER 15, 2016

WASHINGTON, DC

Office of Inspector General

November 15, 2016

Ms. Dana J. Hyde
Chief Executive Officer
Millennium Challenge Corporation
1099 14th Street NW
Washington, DC 20005-2221

Subject: Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Fiscal Years Ending September 30, 2016, and 2015 (Audit Report No. M-000-17-001-C)

Dear Ms. Hyde:

This letter transmits the final report on the subject audit by CliftonLarsonAllen, LLP. The Office of Inspector General (OIG) contracted with the independent certified public accounting firm to audit the financial statements of the Millennium Challenge Corporation (MCC) for the fiscal years (FYs) ending September 30, 2016, and 2015. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards; Office of Management and Budget Bulletin 15-02, Audit Requirements for Federal Financial Statements; and the Government Accountability Office/President's Council on Integrity and Efficiency Financial Audit Manual.

The independent auditor expressed an unmodified opinion and reported that MCC's financial statements as of and for the fiscal years ended September 30, 2016, and 2015, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States. In addition, CliftonLarsonAllen reported no instances of noncompliance with certain provisions of laws and regulations that could have a direct and material effect on the determination of the amounts in the financial statements.

The auditor reported three significant deficiencies involving MCC's internal control over financial reporting.

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 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 deficiencies are listed below and detailed in the auditor's report.

- Control over grant accrual estimates and validation (modified repeat finding).
- Uncorrected misstatements in the Statement of Budgetary Resources (new finding).
- Inadequate funds control system (new finding).

In carrying out its oversight responsibilities, OIG reviewed the audit report and audit documentation provided by CliftonLarsonAllen. This review is different from an audit done 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 controls, or compliance with laws, regulations, contracts, or grant agreements. CliftonLarsonAllen is responsible for the attached auditor's report, dated November 11, 2016, and the conclusions expressed in it. However, our review disclosed no instances in which CliftonLarsonAllen did not comply, in all material respects, with applicable standards.

To address the three significant deficiencies in internal controls reported by CliftonLarsonAllen, we are providing eight recommendations to MCC's management.

Recommendation 1. *We recommend that MCC's Department of Administration and Finance and the chief financial officer update its Expense Accruals Financial Management Procedure Manual to*

a) *Require justification and analysis to be documented, supported, and approved by MCC's management when deviating from its accrual policy and procedures. This should include MCC verification of information provided by the Millennium Challenge Account to support the accrual.*

b) *Include the guidance provided to the Millennium Challenge Accounts on how and what each Millennium Challenge Account will provide as support in addressing the reasonableness of their accrual.*

Recommendation 2. *We recommend that MCC's Department of Administration and Finance and the chief financial officer conduct a comprehensive review and formalize the Grant Accrual Validation Whitepaper as an official policy and procedures document that includes*

a) *Establishing a documented supervisory review of the grant accrual validation to ensure that the validation is performed correctly and is in accordance with MCC's validation methodology.*

b) *Establishing procedures that clearly state how the accrual validation will be carried out when a Millennium Challenge Account is closed out and no longer exists.*

Recommendation 3. *We recommend that MCC's Department of Administration and Finance and the chief financial officer establish internal control procedures to properly review the accounting and reporting of funds returned by the Millennium Challenge Accounts and foreign governments, and other transactions that are not routinely prepared in its financial operations to ensure that these transactions are recorded correctly and in accordance with United States Standard General Ledger.*

Recommendation 4. *We recommend that MCC's Department of Administration and Finance and the chief financial officer establish an internal control process to ensure that financial statements are prepared in accordance with the most current version of Office of Management and Budget A-136.*

Recommendation 5. *We recommend that MCC's Department of Administration and Finance and the chief financial officer conduct a quarterly reconciliation between the status of budgetary resources and the Office of Management and Budget SF-132, Apportionment and Reapportionment Schedule.*

Recommendation 6. *We recommend that MCC's Department of Administration and Finance and the chief financial officer implement a management control to properly review and approve unapportioned funds by programs/projects at the fund level before entries are made.*

Recommendation 7. *We recommend that MCC's Department of Administration and Finance and the chief financial officer implement a management control to review the impact of funds unapportioned at the fund level before apportionment and recoveries adjustments are recorded.*

Recommendation 8. *We recommend that MCC's Department of Administration and Finance and the chief financial officer continue requiring all compact obligating documents be accompanied by an entry-into-force memo prior to recognizing obligation.*

OIG acknowledges MCC's management decisions for all eight 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 during the audit. Please contact Fred Jones at 202-216-6963 if you have any questions concerning this report.

Sincerely,

/s/

Thomas E. Yatsco
Assistant Inspector General for Audit
Office of Inspector General
U.S. Agency for International Development

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

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MILLENNIUM CHALLENGE CORPORATION

September 30, 2016

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CliftonLarsonAllen

CliftonLarsonAllen LLP

www.cliftonlarsonallen.com

INDEPENDENT AUDITORS' REPORT

To the Inspector General
United States 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, 2016 and 2015, and the related statements of net cost, changes in net position, 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.); this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 Bulletin No. 15-02*, Audit Requirements for Federal Financial Statements* (OMB Bulletin 15-02). Those standards and OMB Bulletin 15-02 require that we plan and perform the audits 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 MCC'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 MCC'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.

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INDEPENDENT AUDITORS' REPORT (Continued)

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

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Millennium Challenge Corporation as of September 30, 2016 and 2015, 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. require that the information in MCC's Management Discussion and Analysis (MD&A), and Required Supplementary Information (RSI) sections be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information 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 audits of the financial statements. We do not express an opinion or provide any assurance on this information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The Message from the Chief Executive Officer, Message from the Vice President, Department of Administration and Finance and Chief Financial Officer, and other information, are presented for purposes of additional analysis and is not a required part of the financial statements or RSI. In addition, management has included references to information on websites or other data outside of the Agency Financial Report. This information has not been subjected to the auditing procedures applied in the audits 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 audits 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 statement of assurance 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 statement of assurance on internal control included in the MD&A.

INDEPENDENT AUDITORS' REPORT (Continued)

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, we did identify deficiencies in internal control, summarized below and detailed in Exhibit 1 that we consider as significant deficiencies.

1. Control over grant accrual estimates and validation (Modified Repeat Finding)

2. Uncorrected misstatements in the Statement of Budgetary Resources (New Finding)

3. Inadequate funds control system (New Finding)

Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements 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 noncompliance with which could have a direct effect on the determination of material financial statement amounts and disclosures. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported in accordance with *Government Auditing Standards* or OMB Bulletin 15-02.

Management's Responsibility for Internal Control and Compliance

Management is responsible for (1) evaluating the effectiveness of internal control over financial reporting based on criteria established under 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.

INDEPENDENT AUDITORS' REPORT (Continued)

We did not evaluate all internal controls relevant to operating objectives as broadly established by 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 to certain provisions of laws, regulations, contracts and grant agreements noncompliance with which could have a direct effect on the determination of material financial statement amounts and disclosures. However, providing an opinion on compliance with those provisions was not an objective of our audits, 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 Audit Findings

Management's response to the findings identified in our report is presented in Exhibit 2. 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 November 13, 2015. The status of prior year findings is presented in Exhibit 3.

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

The purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance 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 11, 2016

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EXHIBIT 1
Significant Deficiencies

1. **Control over Grant Accrual Estimates and Validation Continues to be Weak (Modified Repeat Finding)**

MCC reported approximately $428 million in compact grant related expenses and an accrued grant liability of $57 million for expenses incurred but not yet paid by the MCC Compact Accountable Entities (also known as Millennium Challenge Accounts or MCAs) as of September 30, 2016. The compact grant activities are the core of MCC's financial and program operations.

We audited the grant accruals and validation for reasonableness and for compliance with MCC's *Expense Accruals Financial Management Division Procedure Manual* (Manual). During Fiscal Year (FY) 2016, MCC continued to refine its accrual methodology and accumulate the data store[1] to validate its methodology. However, we found the following conditions during our testing that impacted the quarterly grant accrual indicating the need for MCC to continue strengthening its internal control over grant accrual and validation.

a. MCC did not apply its methodology consistently in estimating the amounts to be accrued for one MCA. MCC explained that the MCA's activities were unique from other MCAs, therefore required using in-house invoices instead of the MCC calculated accrual that was higher and using the MCA's estimate that exceeded the unused spending authority for the quarter as a six month spending authority was already approved. While an adjustment from the typical accrual methodology may have been necessary, the methods applied by MCC without some form of verification of the MCA estimated accrual amount raised concerns regarding reliance on the MCA information. Moreover, there was no justification documented for this deviation that was approved by MCC management.

b. MCC's *Grant Accrual Validation Whitepaper* (dated March 22, 2016) provides a methodology for validating grant accrual estimates. However, we found that MCC did not consistently follow its validation methodology for several MCAs. For example, MCC did not test four (4) out of 16 disbursement sample items selected for the month of April during FY 2016 first quarter validation for one MCA. The four sample items not tested totaled $1,299,985 and accounted for 22 percent of the total amount to be tested. Also, MCC incorrectly summarized the validation results for several MCAs. As a result, the reliability of the validation analysis was in questioned.

c. MCC's grant accrual validation methodology was not comprehensive. MCC did not properly consider the subsequent disbursements for expenses and the return of permitted funds in evaluating the applicable costs incurred in validating a prior quarter of a closed compact where the MCA no longer remain. As a result, costs and funds returned were not taken into consideration in the validation analysis.

GAO *Standards for Internal Control in the Federal Government,* Section OV3.05 states that when evaluating implementation, management determines if the control exists and if the entity has placed the control into operation. A deficiency in implementation exists when a

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[1] A data store is a repository for storing and managing collections of data which include not just repositories like databases, but also simpler store types such as simple files, email, etc.

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EXHIBIT 1
Significant Deficiencies

properly designed control is not implemented correctly in the internal control system. 3.09 states that management develops and maintains documentation of its internal control system. 3.10 states that effective documentation assists in management's design of internal control by establishing and communicating who, what, when, where, and why of internal control execution to personnel. 12.03 states that management documents in policies for each unit its responsibility for an operational process's objectives and related risk, and control activity design, implementation, and operating effectiveness.

Recommendation 1. We recommend that MCC's Department of Administration and Finance and the chief financial officer update its *Expense Accruals Financial Management Procedure Manual* to:

a) Require justification and analysis to be documented, supported, and approved by MCC management when deviating from its accrual policy and procedures. This should include MCC verification of information provided by the MCA to support the accrual.

b) Include the guidance provided to the MCA's on how and what each MCA will provide as support in addressing the reasonableness of their accrual.

Recommendation 2. We recommend that MCC's Department of Administration and Finance and the chief financial officer conduct a comprehensive review and formalize the *Grant Accrual Validation Whitepaper* as an official policy and procedures document that includes:

a) Establishing a documented supervisory review of the grant accrual validation to ensure that the validation is performed correctly and is in accordance with MCC's validation methodology.

b) Establishing procedures that clearly state how the accrual validation will be carried out when the Millennium Challenge Account is closed-out and no longer remain.

2. Uncorrected Misstatements in the Statement of Budgetary Resources (New Finding)

An MCA operates for a five-year period from the date a compact agreement entered into force, and closes 120 days after the compact end date. After an MCA is closed, there are instances where funds unused by the MCA or owed by the foreign government and vendors are returned to the U.S. Treasury. The U.S. Treasury reports these "returns" as "offsetting collections."

MCC's Statement of Budgetary Resources (SBR) contained classification errors in different lines such as recoveries of unpaid prior year obligations; apportioned, unexpired account; unapportioned, unexpired accounts; and outlays, gross resulting from incorrect accounting entries and incorrect reporting of funds returned by MCAs. In addition, MCC's SBR was not prepared in accordance with OMB Circular No. A-136, *Financial Reporting Requirements* (OMB A-136), where the Unobligated balance, end of year (SBR line 2490) was not broken out by its components. The uncorrected misstatements and incorrect presentation were due to MCC's ineffective review of the accounting and reporting requirements. MCC did not record these refunds in accordance with OMB Circular A-11, *Preparation, Submission, and*

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EXHIBIT 1
Significant Deficiencies

Execution of the Budget (OMB A-11), and United States Standard General Ledger (USSGL). These errors were brought to MCC's attention during our audit.

OMB A-136 is considered level D of the Federal Generally Accepted Accounting Principles (GAAP) hierarchy because they constitute "practices that are widely recognized and prevalent in the Federal Government." OMB A-136, section II.4.6.1 states that the recognition and measurement of budgetary information reported on this statement should be based on the budget terminology, definitions and guidance in Circular No. A-11.

The USSGL provides a uniform chart of account and technical guidance for standardizing federal agency accounting.

GAO Standards for Internal Control for the Federal Government Section OV2.03 states in "*Accurate and timely recording of transactions:"* Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from its initiation and authorization through its final classification in summary records. In addition, management designs control activities so that all transactions are completely and accurately recorded.

Recommendation 3. We recommend that MCC's Department of Administration and Finance and the chief financial officer establish internal control procedures to properly review the accounting and reporting of funds returned by the Millennium Challenge Accounts and foreign governments, and other transactions that are not routinely prepared in its financial operations to ensure that these transactions are recorded correctly and in accordance with United States Standard General Ledger..

Recommendation 4. We recommend that MCC's Department of Administration and Finance and the chief financial officer establish an internal control process to ensure that financial statements are prepared in accordance with the most current version of Office of Management and Budget A-136.

3. Inadequate Funds Control System (New Finding)

In our review of unapportioned authority by program as of June 30, 2016 and September 30, 2016, we found abnormal and incorrect balances at the program level. We presented the errors as of September 30, 2016 in the table in the next page for illustration purposes:

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EXHIBIT 1
Significant Deficiencies

SF-132 Line No	Category B Description (Fund Level)	Per MCC Trial Balance SGL 445000: Unapportioned Authority [Dr./(Cr.)]	Should Be Balance SGL 445000: Unapportioned Authority [Dr./(Cr.)]	Differences
6011	Compact Fund	($18,936,428)	($33,244,345)	$14,319,252
6013	609g Compact Development Funding	($3,000,231)	$0	$3,000,231
6014	Threshold Fund	$2,400,000 (see further explanation below)	$0	$2,400,000
N/A	Future Fund	($9,507,929) (see further explanation below)	See further explanation below	See further explanation below

- Compact Fund – This fund is reflecting a classification error of $14,319,252.
- 609g Compact Development Funding – This fund is reflecting a classification error of $ 3,000,231.
- Threshold Fund – This fund is reflecting an abnormal debit balance. The normal balance for unapportioned authority (USSGL 445000) is a credit balance.
- Future Fund - MCC utilized the Future Fund to record activities related to annualized level of appropriation provided under the terms of the continuing resolution (CR). MCC was under CR in the early months of FY 2016 until the signing of the 2016 Consolidated Appropriations Act (P.L. 114-113) on December 18, 2015, and a related FY 2016 apportionment was approved by OMB. MCC did not reclassify the account balance to the appropriate funds after the CR ended.

Although the overall impact of these individual errors above may not be reflected on the SBR because the unapportioned authority, which is a component of unobligated balance, is presented on a total basis on the SBR; the classification errors at the fund/program level indicate a funds control system deficiency. OMB A-11, Appendix H, *Checklist for Funds Control Regulations,* states that "…the agency accounting system must fully support agency funds control systems. The accounting systems should provide for preparing and reconciling financial reports that display cumulative obligations, and the remaining unobligated balance by appropriation and allotment, and cumulative obligations by budget activity and object class."

We also noted that funding in the amount of $257 million for a compact agreement signed on October 2, 2015, was obligated on December 3, 2015. However, the compact agreement did not entry-into-force (EIF) until January 20, 2016. MCC's accounting policy for recognition of an obligation is upon a compact agreement entering into force, not upon its signing. MCC DAF made an incorrect assumption that the signing date and the EIF date were the same. MCC recognized this error in January 2016, and took corrective actions.

EXHIBIT 1
Significant Deficiencies

Recommendation 5. We recommend that MCC's Department of Administration and Finance and the chief financial officer conduct a quarterly reconciliation between the status of budgetary resources and the Office of Management and Budget SF-132, *Apportionment and Reapportionment Schedule*.

Recommendation 6. We recommend that MCC's Department of Administration and Finance and the chief financial officer implement a management control to properly review and approve unapportioned funds by programs at the fund level before entries are made.

Recommendation 7. We recommend that MCC's Department of Administration and Finance and the chief financial officer implement a management control to review the impact of funds unapportioned at the fund level before apportionment and recoveries adjustments are recorded.

Recommendation 8. We recommend that MCC's Department of Administration and Finance and the chief financial officer continue requiring all compact obligating documents be accompanied by an entry-into-force memo prior to recognizing obligation.

EXHIBIT 2
Management's Response to Audit Findings

MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

November 15, 2016

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

Thomas E. Yatsco
Assistant Inspector General for Audit
Office of Inspector General
U.S. Agency for International Development
1300 Pennsylvania Avenue, NW
Washington, DC 20005

Dear Ms. Leswing and Mr. Yatsco:

I am pleased to accept your audit report on the Consolidated Financial Statements for Fiscal Year (FY) 2015 and 2016 of the Millennium Challenge Corporation (MCC). MCC has received an unmodified opinion on its financial statements with no material weaknesses for the second consecutive year. In response to the audit findings and recommendations provided in your financial statement audit report, MCC has the following comments:

Significant Deficiency: Control over Grant Accrual Estimates and Validation Continues to be Weak (Modified Repeat Finding)

Recommendation 1:

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer update its *Expense Accruals Financial Management Procedure Manual* to:

a) Require justification and analysis to be documented, supported, and approved by MCC management when deviating from its accrual policy and procedures. This should include MCC verification of information provided by the MCA to support the accrual.

b) Include the guidance provided to the MCA's on how and what each MCA will provide as support in addressing the reasonableness of their accrual.

1099 Fourteenth Street NW | 7th Floor | Washington | DC 20005 | P: (202) 521-3600 | WWW.MCC.GOV

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EXHIBIT 2
Management's Response to Audit Findings

Recommendation 2:

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer conduct a comprehensive review and formalize the *Grant Accrual Validation Whitepaper* as an official policy and procedures document that includes:

a) Establishing a documented supervisory review of the grant accrual validation to ensure that the validation is performed correctly and is in accordance with MCC's validation methodology.

b) Establishing procedures that clearly state how the accrual validation will be carried out when the MCA is closed-out and no longer exist.

MCC Response:

MCC concurs with recommendations 1 and 2. A comprehensive corrective action plan will be developed to address the deficiency noted.

Significant Deficiency: Uncorrected Misstatements in the Statement of Budgetary Resources (New Finding)

Recommendation 3:

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer establish internal control procedures to properly review the accounting and reporting of funds returned by the MCAs and foreign governments, and other transactions that are not routinely prepared in its financial operations to ensure that these transactions are recorded correctly and in accordance with USSGL.

Recommendation 4:

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer establish internal control process to ensure that financial statements are prepared in accordance with the most current version of OMB A-136.

MCC Response:

MCC concurs with recommendations 3 and 4. A comprehensive corrective action plan will be developed to address the deficiency noted.

2-2

EXHIBIT 2
Management's Response to Audit Findings

Significant Deficiency: Inadequate Funds Control System (New Finding)

Recommendation 5:

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer conduct a quarterly reconciliation of the status of budgetary resources to the OMB SF-132, Apportionment and Reapportionment Schedule.

Recommendation 6:

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer implement a management control to properly review and approve unapportioned funds by programs to the fund level before entries are made.

Recommendation 7:

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer implement a management control to review the impact of funds unapportioned at the fund level before apportionment and recoveries adjustments are recorded.

Recommendation 8:

We recommend that MCC's Department of Administration and Finance and the Chief Financial Officer continue requiring all compact obligating documents be accompanied by an EIF memo prior to recognizing obligation.

MCC Response:

MCC concurs with recommendations 5, 6, 7, and 8. A comprehensive corrective action plan will be developed to address the deficiency noted.

Sincerely,

Mahmoud Bah
Acting Vice President and Chief Financial Officer
Department of Administration and Finance

2-3

EXHIBIT 3
Status of Prior Year Recommendations

Our assessment of the current status of the recommendations related to findings identified in the prior year audit is presented below:

FY 2015 Recommendations	***Type***	***Fiscal Year 2016 Status***
1. Perform a more comprehensive review of advances by comparing MCA advances reported to MCC to the source data maintained by the fiscal agent.	Significant Deficiency (SD)	Closed
2. Employ substantive fluctuation and trend analysis of the advances account and promptly investigate fluctuation and trends.	SD	Closed
3. Enhance MCC's *Expense Accruals Financial Management Division Procedure Manual.*	SD	In-Process – Reported as a Modified Repeat Finding – SD
4. Investigate and correct the root causes for the system limitations or problems that prevent or delay the recording and summarizing of accounting transactions.	SD	Open – Reported as management letter comment

U.S. Agency for International Development
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Task No. MM100716

Other Information

Other Information

Combined Schedule of Spending

The Combined Schedule of Spending (SOS) presents an overview of how and where MCC is spending its money. The data used to populate this schedule is the same underlying data used to populate the SBR. The budgetary information in this schedule is presented on a combined basis and not a consolidated basis. The sections of the SOS are as follows:

- "What Money is Available to Spend" summarizes the resources that were available to spend.
- "How Was the Money Spent" summarizes MCC's outlays for the FY, categorized by the budget object class definitions found in OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget.* The Other line is comprised of adjusting entries primarily related to the de-obligation of closed compacts.
- "Who Did the Money Go To" summarizes MCC's obligations by Federal and Non-Federal components.

The "Total Amounts Agreed to be Spent" in each section is equal to "New Obligations and Upward Adjustments" on the SBR.

Similar data is also submitted to USASpending.gov; however, the amounts will not reconcile primarily due to differences in timing and reporting requirements. Obligations included in the SOS that are not included on USASpending.gov generally include: travel and training, employee salaries and benefits, and IAAs. The SOS also includes accruals and other financial information applicable to, but posted subsequent to September 30, 2016 and 2015. USASpending.gov is based on financial information as of September 30.

Combined Schedule of Spending (dollars in thousands)

For the Year Ended September 30,	2016 Compact	2016 609(g)	2016 614(g)	2016 Threshold	2016 Due Diligence	2016 Audit	2016 Admin	2016 Futures	2016 Total	2015 Total
What Money is Available to Spend?										
Total Resources	$ 2,923,058	$ 29,614	$ 155	$ 113,795	$ 104,757	$ 5,799	$ 111,688	$ 9,508	$ 3,298,374	$ 2,779,433
Less Amount Available but Not Agreed to be Spent	2,131,703	3,864	151	40,395	40,058	7	9,149	—	2,225,327	2,272,687
Less Amount Not Available to be Spent	18,944	3,000	4	1,000	—	799	—	9,508	33,255	38,772
Total Amounts Agreed to Be Spent	**$ 772,411**	**$ 22,750**	**$ —**	**$ 72,400**	**$ 64,699**	**$ 4,993**	**$ 102,539**	**$ —**	**$ 1,039,792**	**$ 467,974**
How Was the Money Spent/Issued?										
Personnel Compensation and Benefits	$ —	$ —	$ —	$ —	$ —	$ —	$ 51,887	$ —	$ 51,887	$ 46,382
Contractual Services and Supplies	—	—	—	—	64,493	2	48,209	—	112,704	93,593
Acquisition of Assets	—	—	—	—	—	—	2,508	—	2,508	4,909
Grants and Fixed Charges	769,783	22,743	—	72,400	206	—	128	—	865,260	283,925
Other	2,628	7	—	—	—	4,991	(193)	—	7,433	39,165
Total Amounts Agreed to Be Spent	**$ 772,411**	**$ 22,750**	**$ —**	**$ 72,400**	**$ 64,699**	**$ 4,993**	**$ 102,539**	**$ —**	**$ 1,039,792**	**$ 467,974**
Who Did the Money Go To?										
Federal Entities	$ 68	$ 4,733	$ —	$ 21,667	$ 7,086	$ 4,788	$ 23,736	$ —	$ 62,078	$ 53,187
Non-Federal	772,343	18,017	—	50,733	57,613	205	78,803	—	977,714	414,787
Total Amounts Agreed to Be Spent	**$ 772,411**	**$ 22,750**	**$ —**	**$ 72,400**	**$ 64,699**	**$ 4,993**	**$ 102,539**	**$ —**	**$ 1,039,792**	**$ 467,974**

Fiscal Year 2017 Top Management Challenges Identified by the Inspector General

Ann Calvaresi Barr
Inspector General

Message From the Inspector General

The U.S. Agency for International Development (USAID) supports the United States' commitment to help developing countries tackle problems such as child and maternal mortality, hunger, education, and gender inequality, while providing humanitarian assistance to populations besieged by natural disasters, epidemics, and conflicts. The Millennium Challenge Corporation (MCC) complements USAID's mission by combating global poverty through investments in select countries. USAID and MCC—along with the United States African Development Foundation (USADF), the Inter-American Foundation (IAF), and the Overseas Private Investment Corporation (OPIC)—together spend up to $15 billion annually to advance economic growth and democracy, which promote U.S. national security interests around the world.

To help provide maximum return on these investments, OIG provides independent oversight of USAID, MCC, OPIC, USADF, and IAF.[1] As part of this oversight, the Reports Consolidation Act of 2000 (Public Law 106–531) requires each applicable Federal agency to include in its performance and accountability report a statement by its inspector general summarizing the most serious challenges facing the agency and the progress it has made in addressing them.

From our recent audits and investigations, we identified five top management challenges for USAID and one for MCC for fiscal year 2017:[2]

- **Developing strategies to work effectively in nonpermissive and contingency environments.**[3] Working in regions characterized by conflict, political instability, or cataclysmic natural events creates significant barriers to finding qualified contractors and grantees and monitoring programs and projects.
- **Strengthening local capacity and sustainability while ensuring adequate oversight of USAID funds.** USAID invests in development projects that it expects can be supported locally and have a lasting impact, but OIG continues to report concerns about USAID's level of assurance that partner countries can sustain these projects.

[1] *OIG also provides oversight of overseas contingency operations as part of lead inspector general initiatives (described in section 8L of the Inspector General Act, as amended).*

[2] *In reviewing our recent work for USADF and the IAF, we did not identify any serious management and performance challenges for them for fiscal year 2017.*

[3] *Work in nonpermissive and contingency environments includes overseas contingency operations, which integrate the efforts of the Departments of Defense and State, USAID, and other partners to respond to conflicts and emergencies.*

- **Reconciling interagency priorities to advance international development.** In carrying out operations that require coordination with other U.S. Government agencies, USAID employees are at times unclear as to how to manage additional layers of review and balance competing objectives.
- **Improving program design and contractor and grantee monitoring.** Shortcomings in program design and monitoring have weakened USAID's ability to ensure programs have the resources needed to achieve objectives and identify and address fraud and other program risks.
- **Meeting governmentwide financial and information management requirements.** USAID continues to work to meet critical financial and information management requirements to better ensure it is an effective steward of U.S. Government resources.
- **Achieving effective development and implementation of MCC programs and proper stewardship of corporation resources and information.** MCC does not always accurately assess country capacity and develop sound compacts to help ensure project sustainability. Further, it lacks sufficient internal controls to ensure compliance with some U.S. Government financial and information management requirements.

In addition to meeting the requirements of the Reports Consolidation Act, this document will help inform our work and frame our dialogues with the current and next Congress and Administration to pursue stakeholder priorities for effective stewardship of U.S. funds dedicated to foreign aid and development.

OIG remains committed to conducting thorough and timely audits and investigations of USAID and MCC programs and, when appropriate, recommending actions to help the USAID Administrator and MCC Chief Executive Officer address the significant challenges they face.

If you would like to discuss or have any questions about these challenges, please contact me at 202-712-1150.

Achieving Effective Development and Implementation of MCC Programs and Proper Stewardship of Corporation Resources and Information

The Millennium Challenge Corporation (MCC) was established in 2004 to lead a new approach to U.S. foreign assistance: reducing poverty through economic growth. MCC determines countries' eligibility for assistance through a competitive process using independent measures to score their policy performance in governance, economic freedom, and investment in people. Accurately assessing country capacity and developing sound compacts have been challenges for MCC.

Accurately Assessing Partner-Country Capacity

In principle, the MCC model requires partner countries to take the lead in identifying and analyzing binding constraints to economic growth and poverty reduction, developing compact proposals, implementing MCC-funded programs, and taking steps to sustain the programs when MCC funding ends—5 years after the compact enters into force. Country ownership therefore depends on the countries' capacity to develop, plan, and execute compacts.

However, in practice, some countries have lacked the institutional capacity and technical competence needed to manage and implement complex projects. For example, in August 2015, we reported that not all accountable entities—which are established by partner-country governments to carry out responsibil¬ities and obligations under the compact—had the ability to develop contract plans and specifications in accordance with MCC's program procurement standards, nor did they have the marketing know-how to attract sufficient numbers of qualified contractors. Other entities lacked effective political leadership or commitment to implement MCC-funded projects successfully, as our June 2012 report on the Benin port project pointed out.

Designing and Implementing Compacts

In July 2015, we reported that a poor quality design study was responsible for significant delays in an irri¬gation rehabilitation project in Moldova. We similarly reported in March 2013 that in-kind land transfers planned to compensate those resettled under an MCC-funded irrigation project in Senegal were found to be unsuitable.

Completing complex sets of projects within the 5-year time span has been a persistent challenge for MCC. Our review of 23 early compacts determined that 9 had undergone significant modifications because of insufficient planning and difficulties with implementation, including cost escalation, contractor performance, design modifications, compliance with conditions precedent, and policy and institutional support in partner countries.

Sustaining Compact Benefits

Our prior work also identified concerns over the compacts' ability to achieve their ultimate objective to sustain the projects MCC has invested in to reduce poverty through economic growth. Poor planning and implementation undermine sustainability. For example, untimely training for water user association members on the operations and maintenance of MCC-funded irrigation systems in Moldova deprived them of sufficient operating experience prior to the compact end date, increasing the risk that the associations would not have the capacity to manage and maintain the new irrigation systems. Uncertainty over funding for completing projects that are not finished when the compact expires, limited resources and capacity for maintaining compact-funded infrastructure, and limited or no in country presence after the compact ends make sustaining benefits a major challenge.

Being a Good Steward of Corporation Resources and Information

MCC plays a critical role in making sure that its funds are properly used by the accountable entities and in its operations. In May 2016, we reported that MCC was not in compliance with the Improper Payments Elimination and Recovery Act of 2010. Our audit demonstrated the need for MCC to conduct sufficient risk assessments and strengthen internal controls over improper payments to assist with proper stewardship of the agency's resources.

Our review of MCC's classified national security information program found it does not fully meet Federal requirements. Specifically, MCC's program policies and procedures omit key requirements for training, monitoring compliance, challenging classification, and fundamental guidance reviews. For example, MCC did not effectively conduct a self-inspection program in fiscal year 2015. Further, MCC did not have a policy for declassifying some of its board meeting transcripts and minutes that had reached their declassification dates. MCC planned to create such a policy that would cover review procedures. MCC also lacked documentation of key internal controls for derivatively classifying board meeting transcripts and minutes, providing access to Department of State cables, and maintaining a security incident log. Lastly, we found that MCC had not implemented corrective actions effectively to address recommendations from our prior review in 2015. Until the corrective actions are implemented, MCC's classification policies and procedures remain a management challenge.

MCC has taken several actions to address these challenges, including revising the compact development process to have many planning activities completed prior to compact signing or entry-into-force. MCC also issued a number of guidelines to help MCC and partner countries better prepare the projects. Despite these actions, project planning and preparation, along with strengthening processes and tools to effectively manage implementation risks, continue to be management challenges.

Related OIG Products

- "Millennium Challenge Corporation's Implementation of Executive Order 13526, Classified National Security Information, Needs Strengthening" (M-000-16-001-S), September 30, 2016
- "Audit of the Millennium Challenge Corporation's Fiscal Year 2015 Compliance with the Improper Payments Elimination and Recovery Act of 2010" (M-000-16-002-C), May 13, 2016
- "Review of the Millennium Challenge Corporation's Procurement Process for Selected Country Programs" (M-000-15-006-S), August 12, 2015
- "Review of the Millennium Challenge Corporation's Transition to High-Value Agriculture Project in Moldova" (M-000-15-005-S), July 28, 2015
- "Audit of the Millennium Challenge Corporation's Funded Program in Senegal" (M-000-13-001-S), March 20, 2013
- "Audit of the Millennium Challenge Corporation's Programs in Mozambique" (M-000-13-003-P), January 31, 2013
- "Review of the Millennium Challenge Corporation's Compact Modifications" (M-000-12-006-S), July 16, 2012
- "Review of Millennium Challenge Corporation-Funded Project Activities in Benin" (M-000-12-005-S), June 3, 2012

Appendix

Fiscal Year 2017 and Prior Year Top Management Challenges for MCC

Fiscal Year 2017 Challenges

- Accurately assessing partner-country capacity
- Designing and implementing compacts
- Sustaining compact benefits
- Being a good steward of corporation resources and information

Prior Year Challenges

- Developing compacts
- Implementing compacts
- Sustaining compact benefits
- Managing finances efficiently

MCC Management's Response to the Inspector General

MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

November 14, 2016

Ms. Ann Calvaresi Barr
Inspector General
U.S. Agency of International Development
1300 Pennsylvania Avenue, NW
Washington, DC 20523

Dear Ms. Barr:

I am writing in response to the Office of Inspector General's (OIG's) *Fiscal Year 2017 Top Management Challenges* (the "OIG 2017 Statement"), which identified Millennium Challenge Corporation (MCC) management challenges in the following areas: (1) accurately assessing partner-country capacity; (2) designing and implementing compacts; (3) sustaining compact benefits; and (4) being a good steward of corporation resources and information.

Attached you will find a summary of MCC's response to the OIG 2017 Statement, including an overview and detailed responses to each of the identified challenges.

We look forward to continued constructive engagement with the OIG as we work together to enhance our ability to perform MCC's mission effectively.

Sincerely,

Dana J. Hyde
Chief Executive Officer
Millennium Challenge Corporation

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MILLENNIUM
CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Summary of MCC's Response to OIG FY 2017 Top Management Challenges Letter

Set forth below you will find the Millennium Challenge Corporation's (MCC) response to the Office of Inspector General's (OIG) Fiscal Year 2017 Top Management Challenges (the "OIG 2017 Statement"). The OIG's 2017 Statement identified the following management challenges for MCC: achieving effective development and implementation of MCC programs and proper stewardship of corporation resources and information.

MCC is committed to enhancing the effectiveness of our work and operations. However, it is imperative to highlight at the outset several overarching issues in response to the broad assertions set forth in the OIG 2017 Statement.

- First, the OIG's assertions and conclusions are not supported by new or recent audits. The OIG did not issue any new performance audits of MCC's programs in fiscal year (FY) 2015 or FY 2016. Excluding mandated GAO/OMB required audits:
    - In FY 2014, the OIG completed 2 of 10 planned program audits.
    - In FY 2015, the OIG completed 0 of 11 planned program audits.
    - In FY 2016, the OIG completed 0 of 6 planned program audits and cancelled the issuance of 2 program audits conducted in FY 2015.

- Second, even where reports were issued more recently, the reports cited to support the challenges of: (1) accurately assessing partner-country capacity; (2) designing and implementing compacts; and (3) sustaining compact benefits, date from audit/review fieldwork performed before 9/30/2013, as summarized below:

    - MCC's Procurement Process, Aug 2015 [Field work Sept 2014] – Closed
    - Project in Moldova, July 2015 [Field work Aug/Dec, 2013] – Closed
    - Program in Senegal, March 2013 [Field work Nov 2012 to Feb 2013] – Closed
    - Programs in Mozambique, January 2013 [Field work May-Sep 2012] – Closed
    - Compact Modifications, July 2012 [Field work Nov 2011 - April 2012] – Closed
    - Project Activities in Benin, June 2012 [Field work Oct-Nov 2011] – Closed

- Third, in relying on older performance audits, the OIG 2017 Statement does not highlight MCC actions already taken in response to these prior audit recommendations, which the OIG previously accepted as final action and closed.

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- Finally, the OIG 2017 Statement makes broad generalizations identifying challenges like sustainability and country capacity that are, and will always be, inherent to the process of development. Because the OIG has not identified particular benchmarks or weaknesses that MCC should target through recent audit work, MCC's responses necessarily refer to previously taken and agreed actions.

Below is a detailed and comprehensive response to the challenges noted in the OIG 2017 Statement.

Attachment: Detailed Response to OIG FY 2017 Top Management Challenges Letter

Chapter 6. Achieving Effective Development and Implementation of MCC Programs and Proper Stewardship of Corporation Resources and Information

Accurately Assessing Partner-Country Capacity

The OIG notes that some MCC partner countries have lacked the institutional capacity and technical competence needed to manage and implement complex projects. While this has been a challenge for MCC – as it is for any development institution – the examples cited by the OIG in support of this challenge are derived from audit reports issued in 2015 and 2012, with underlying fieldwork completed as far back as 2013 and 2011. Further, in some cases the MCC programs under review in such reports were designed in 2006/2007 – for example, the first Benin compact. MCC has evolved substantially since that time, undercutting the continuing validity of this challenge. Moreover, each recommendation identified in the reports cited by the OIG have been previously addressed by MCC, meaning that the overall challenge is not based on new data or findings to which MCC might be able to respond.

Specifically, the OIG has cited an August 2015[1] report that found not all country partners had the ability to develop contract plans and specifications in accordance with MCC's program procurement standards, nor did they have the marketing know-how to attract sufficient qualified contractors. During FY 2016, MCC successfully addressed this recommendations and communicated final actions to the OIG in May 2016.

Regarding contract plans and specifications, these actions included:

- the development of guidance on preparing terms of reference (TOR), which was distributed to MCC staff on May 2, 2016, as well as training programs for partner-country Management Challenge Account entities (MCAs) to provide direct support on TOR drafting. MCC's program procurement guidelines, which govern procurements conducted by MCAs, require that TORs, standards, and specifications be developed to promote the broadest possible competition while meeting the project's stringent technical, environmental, social, and gender requirements.
- as an additional assurance that MCAs engage qualified contractors, MCC maintains a Contractor Past Performance Reporting System (CPPRS) database where all MCAs are required to regularly submit their contractor performance evaluations. MCC requires MCAs to check the CPPRS database during the evaluation process. Effective January 1, 2016, MCC requires MCC procurement directors to assess an MCA's use of the system during all in-country visits and include their findings in trip reports.

To enhance MCAs' capacity to attract sufficient qualified contractors, MCC continues to focus its efforts on increasing market awareness for compact-related procurement opportunities. This is accomplished by directly engaging the private sector community both in the U.S. and overseas, as

[1] *Review of the Millennium Challenge Corporation's Procurement Process for Selected Country Programs,* Report No. M-000-15-006-S, August 12, 2015. Fieldwork on this review was completed on September 4, 2014.

well as training MCAs to do the same via the market outreach strategy distributed to all MCAs in April 2016. Specifically, MCC:

- developed a "market analysis toolkit" that was tested and distributed in April 2016 to all MCAs. MCC also continues to enforce requirements to convene in-country outreach seminars and hold pre-bid conferences on most large contracts.
- has instituted more active outreach to the U.S. bidding community through the organization of, and participation in, domestic outreach events. In FY 2016, MCC conducted 15 domestic outreach events as well as frequent outreach meetings with individual firms that contact MCC.

In addition to the procurement-related issues discussed above, the OIG states that other entities lacked effective political leadership or commitment to implement MCC-funded projects successfully, citing a June 2012 OIG report[2] on the Benin port project. In its notice of final action on the Benin port project report, dated June 6, 2013, MCC stated it had expressed concern about the continuity of management at the Port of Cotonou and port security throughout implementation of the compact via formal letters and bilateral discussions with relevant authorities. MCC also confirmed that a port security management plan was finalized and approved on January 19, 2012 to ensure security management would be sustained post-compact.

Designing and Implementing Compacts

The OIG has also identified a challenge with respect to designing and implementing compacts. To substantiate this challenge, the OIG cites reports from prior fiscal years for which all recommendations have already been addressed and reported on via previous management challenge responses. The most recent fieldwork cited in support of this challenge was completed in 2013. In the case of the OIG's report on Compact Modifications, fieldwork was completed in 2012 and only covers MCC's very first set of compact programs, the design of which does not accurately reflect current MCC practice. Moreover, contrary to the OIG's implicit assertion, MCC believes that one key to improving project success rates is the continuous collection and analysis of data and information to enable course corrections and inform future program design, meaning modifications are often a prudent response to anticipated changes during the project lifecycle.

Specifically, the OIG cited the July 2015[3] report that concluded poor quality design study was responsible for significant delays in an irrigation rehabilitation project in Moldova. This finding was based upon fieldwork completed in 2013, and was previously highlighted in the OIG's FY 2015 management challenges. As MCC previously responded, a review of alternatives was completed in FY 2013 and shared with the OIG at that time. The alternative selected and deployed by MCC led to an improved project design that lowered costs and allowed the Moldova Compact to achieve original output targets while maintaining the projected activity completion dates.

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[2] Review of the Millennium Challenge Corporation – Funded Project Activities in Benin, Report No. M-000-12-005-S, June 3, 2012, Field Work completed on April 2012.

[3] Review of the Millennium Challenge Corporation's Transition to High-Value Agriculture Project in Moldova, Report No. M-000-15-005-S, July 28, 2015. Fieldwork on this review was completed on September 20, 2013.

Subsequently, in 2014, MCC undertook and completed a thorough review of its entire compact development process. This examination resulted in several process changes including several additional approvals by its internal Investment Management Committee and Chief Executive Officer. MCC reported on these changes in its July 7, 2015 response to the FY 2015 Moldova audit report, which included a new expectation for compact development teams to submit their due diligence findings and proposed project designs to internal peer reviews by relevant technical experts. These technical reviews provide additional technical oversight to assess and corroborate the quality of proposed projects before final investment decisions are made.

OIG also cited a March 2013 report[4] that found in-kind land transfers, planned to compensate those resettled under an MCC-funded irrigation project in Senegal, were unsuitable. MCC reported the completion of final corrective actions on this audit in March 2013, confirming that MCA-Senegal had identified viable alternatives for compensating all project affected persons (PAP). Specifically, MCA-Senegal (with MCC's assistance and oversight) took the following steps: (1) finalized all resettlement action plans and developed a realistic timetable for all resettlement tasks to be implemented; and (2) found replacement land for PAP cases that had larger losses of land or who would not accept cash compensation in the Delta. MCC also approved contracts with a financial institution to ensure timely, secure, and verifiable delivery of compensation to PAPs. MCC also reported that MCA-Senegal developed two written resettlement implementation plans as well as a dashboard to ensure timely implementation of resettlement activities.

In discussing challenges associated with the design and implementation of compacts, OIG also states that completing complex projects within the prescribed five-year period has been a persistent challenge for MCC. As evidence of this challenge, OIG cited its 2012 audit report reviewing compact modifications[5] that determined 9 of 23 early compacts had undergone significant modifications because of insufficient planning and difficulties with implementation. The report documentation does not include compelling or timely evidence that would suggest MCC faces a significant management challenge with respect to completing complex projects. Further, the 2012 review explicitly did not contain any OIG recommendations to address compact planning and implementation challenges.

MCC understands the inherently challenging nature of implementing complex economic growth projects with fixed budgets and timelines in some of its least developed partner countries. Many of MCC's foreign assistance peers report project failure rates in excess of 50 percent. MCC believes that one key to improving project success rates is the continuous collection and analysis of data and information throughout the development and implementation process. Additionally, MCC maintains a willingness to adapt implementation approaches when the data and information collected suggests an agreed-upon approach may not succeed or may not achieve the desired results.

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[4] Review of the Millennium Challenge Corporation's Funded Program in Senegal (M-000-13-001-S), March 20, 2013. Fieldwork on this review was completed on Feb 2013.
[5] Review of the Millennium Challenge Corporation's Compact Modifications" (M-000-12-006-S), July 16, 2012. Fieldwork on this review was completed on April 2012.

As indicated in the OIG's 2012 audit report, MCC has learned valuable lessons from the implementation of its earliest compacts, including the 23 compact programs referenced above. As a result of those lessons learned, MCC has adjusted its approach to development work to better mitigate inherent risks. For instance, MCC has streamlined its compact programs to emphasize specific sectors. Since 2012, half of all approved compacts encompass only a single sector, while most of the remaining compacts focused on two sectors. Additionally, in an effort to ensure broad application of best practices and lessons learned, MCC's Department of Compact Operations created practice groups of technical specialists and strengthened the role of practice leaders in the development of compact programs. This change was a direct result of the MCC internal management review performed during 2013. In adjustments to its internal process in 2014, MCC introduced additional senior management decision points to more clearly define the expected evolution of projects and to strengthen compact development oversight. And, in a recently completed review of MCC's criteria for investment decisions, MCC set a new requirement that each project demonstrate a clear pathway toward implementation well within a five year compact term. MCC will soon begin piloting a "readiness" tool to help measure the level of project preparation and the expected implementation timeline when a compact program is approved.

Sustaining Compact Benefits

The OIG states that its prior work also identified concerns with the sustainability of MCC programs. Project sustainability is a challenge for any development institution, and MCC always seeks to leverage lessons learned, including previous audit findings, to improve the sustainability of our projects and operations. However, the reports cited by the OIG in support of this assertion reiterate old findings to which MCC has taken action and are based on dated fieldwork.

For example, the OIG cited the previously referenced 2015 OIG report[6] on Moldova. This report asserted sustainability risks related to the structure water user associations, the availability of continued funding, and the ongoing maintenance of water systems. MCC's previous response, dated July 7, 2015, provided details regarding the actions taken by MCC to enhance the water user associations' (WUAs) preparation and capacity to sustain the benefits of the new irrigation systems. In particular, MCC explained that eleven WUAs were established prior to compact closure. MCC and MCA-Moldova conducted sustainability workshops in June and July of 2013, prior to the start of the performance audit, to identify the biggest risks to the sustainability of compact investments. Following such workshops, MCC and MCA-Moldova developed a sustainability plan in which potential WUA risks were a top priority.

MCC's response to the 2015 Moldova audit report further explained that MCC and MCA-Moldova developed a strong path to sustainability for the WUAs, which includes: (1) the U.S. Agency for International Development will provide robust technical support to the WUAs to help them enhance and grow their skills in operating and maintaining the new irrigation systems; (2) the Government of Moldova will provide up to $8 million to continue the operation of the compact implementing unit for at least two years after compact end date; (3) MCC approved a budget and

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[6] Review of the Millennium Challenge Corporation's Transition to High-Value Agriculture Project in Moldova, Report No. M-000-15-005-S, July 28, 2015. Fieldwork on this review was completed on September 20, 2013.

scope of work for Moldova that prioritizes support for WUA sustainability; and (4) as a direct result of an MCC-sponsored donors forum, in November 2015, the European Union began discussions with the Government of Moldova, MCC, and MCA-Moldova to provide substantial capital funding to extend the MCC-funded irrigation systems in the south of the country by about 80 percent, adding an additional 3,000 hectares under irrigation.

MCC continues to monitor the sustainability of the Moldova program through ongoing impact evaluations.

Being a Good Steward of Corporation Resources and Information

There is nothing MCC takes more seriously than its role as a good steward of taxpayer funds. For FY 2015 and FY 2016, MCC earned clean audit opinions and received no material weaknesses. MCC will continue to strive to be a good steward of resources and information, as it has in the past. Importantly, the specific audit cited by the OIG in support of this challenge did not identify any instance of improper payments, but rather a lack of complete documentation and proper disclosure. MCC is already implementing an action plan to remedy these outstanding audit findings.

Specifically, MCC utilized the observations and recommendations included in the report, *Audit of the Millennium Challenge Corporation's Fiscal Year 2015 Compliance With the Improper Payments Elimination and Recovery Act of 2010 (IPERA)*[7], to strengthen its internal controls over improper payments and risk assessment methodology. As noted above, the report noted that no improper payments were identified during the audit, but focused on recommended improvements to MCC's risk assessment methodology and documentation, financial statement note disclosures, and MCC's self-identified improper payments. MCC made significant strides since the report's issuance in May 2015 in addressing the recommendations to ensure the agency is in compliance with the IPERA requirements in FY 2016 and beyond.

Additionally, the report titled, *Millennium Challenge Corporation's Implementation of the Executive Order 13526, Classified National Security Information, Needs Strengthening*[8], cited no issues or concerns related to overclassifying information and found no evidence of mishandling of classified information. MCC's constructive response to the report was a corrective action plan that will bring MCC into full compliance with Executive Order requirements and its implementing regulations. The corrective actions detailed in MCC's response, which are currently being implemented, will improve the agency's self-inspection program; assure complete training program coverage to improve the workforce's understanding of requirements and responsibilities; and formalize written policies and procedures.

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7 Audit of the Millennium Challenge Corporation's Fiscal Year 2015 Compliance with the Improper Payments Elimination and Recovery Act of 2010" (M-000-16-002-C), May 13, 2016

8 Millennium Challenge Corporation's Implementation of Executive Order 13526, Classified National Security Information, Needs Strengthening (M-000-16-001-S), September 30, 2016

Summaries of Financial Statements 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		0		0		0
Total Material Weaknesses		**0**		**0**		**0**

Table 2. Summary of Management Assurances

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

Statement of Assurance	Unmodified					
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
None	0					0
Total Material Weaknesses	**0**					**0**

Effectiveness of Internal Control over Operations (FMFIA §2)

Statement of Assurance	Unmodified					
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
None	0					0
Total Material Weaknesses	**0**					**0**

Conformance with Federal Financial Management System Requirements (FMFIA §4)

Statement of Assurance	System conforms					
Non-Conformances	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
None	0					0
Total Non-Conformances	**0**					**0**

Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)[15]

	Agency	**Auditor[16]**
1. System Requirements	No lack of compliance noted	No lack of compliance noted
2. Accounting Standards	No lack of compliance noted	No lack of compliance noted
3. USSGL at Transaction Level	No lack of compliance noted	No lack of compliance noted

Improper Payments Information Act Report

Improper Payments Information Act Assessment

MCC is dedicated to reducing fraud, waste, and abuse by adequately reviewing and reporting programs susceptible to improper payments in accordance with the Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control,* Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments.* To improve the integrity of the Federal government's payments and the efficiency of its programs and activities, Congress enacted the IPIA of 2002 (PL 107-300). The IPIA contains requirements in the areas of improper payment identification and reporting. It requires agency heads to annually review all programs and activities, identify those that may be susceptible to significant improper payments, estimate annual improper payments in susceptible programs and activities, and report the results of their improper payment activities.

OMB issued Memorandum M-15-02, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123,* modifying Circular A-123 Appendix C, Part I and Part II (which was issued in August 2006 as OMB Memorandum M-06-23). OMB Memorandum M-15-02 requires each Executive branch agency to:

- Review all funds to identify those susceptible to significant improper payments. OMB defines significant improper payments as gross annual improper payments (i.e., the total amount of overpayments plus underpayments) in the program exceeding (1) both 1.5 percent of program outlays and $10,000,000 of all program or activity payments made during the FY reported or (2) $100,000,000 (regardless of the improper payment percentage of total program outlays).
- Obtain a statistically valid estimate of the annual amount of improper payments in programs and activities for those programs that are identified as susceptible to significant improper payments.
- Implement a plan to reduce improper payments.
- Report estimates of the annual amount of improper payments in programs and activities and progress in reducing them.

OMB Circular No. A-123, Appendix C, 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 that are 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 as a result of insufficient or lack of documentation, this payment must also be considered an improper payment.

Improper Payments Information Act Reporting Details

To conduct the FY 2016 IPIA assessment, MCC considered lessons learned from past assessments, including USAID's OIG recommendations, and updated the prior year risk assessment methodology. In order to satisfy the requirements the following tasks and activities were executed:

- Reviewed and updated the FY 2015 risk assessment of all programs;

- Selected a statistically valid sample of payments for funds as a baseline;
- Conducted a test of all transactions selected in the sample and extrapolated the results to make a valid estimate; and
- Reported on the details of testing and findings (for which there where zero identified) of the program.

I. Risk Assessment

In order to identify improper payments and assess MCC's compliance with OMB Circular No. A-123, Appendix C, MCC conducted a risk assessment for all eight MCC funds. The FY 2016 risk assessment was updated from previous year results and incorporated all risk factors as identified in OMB Circular No. A-123, Appendix C. The risk assessment methodology consisted of measuring and scoring each MCC fund and program area by risk factors in order to estimate the probability and impact of risk and resulting in an overall rating of low, medium, or high. Table 1.1 below identifies the risk factors and provides examples of the components which encompassed each factor.

In addition, a payment inventory was conducted as part of the overall risk assessment. The payment inventory included the total amount of disbursements made by fund as well as an estimate of the total amount of known improper payments identified by MCC, as shown in Table 1.2 below. The period of payment inventory and identified improper payments is July 1, 2015 through June 30, 2016. The table also provides the list of all MCC administered funds that were assessed for risk of improper payment.

Table 1.1: Risk Factors

Risk Factor	Component Examples
Recent Changes in Authorities, Practices, and/or Procedures	Significant changes in funding, authorities, practices, or procedures were made in recent FYs, are in process in the current year, or planned in future years.
Results of External and Internal Reviews	Prior year OMB Circular A-123 assessments, GAO and OIG audits and reviews, and internal reviews that identified any design or control deficiencies that have or could result in significant improper payments.
Monitoring Activities	Effectiveness and results of established management reviews and monitoring activities.
Degree of Stability and Payment Eligibility Decisions	Longevity and stability of each fund and program.
Process Complexities	Similarity of transactions and consistent application of controls.
Payment Volume and Amount	Risk level associated with payment volume and amount, and the relationship to processing type (i.e., automated vs. manual).
Inherent Risk	Risk if no controls existed around the payment process with considerations of risk related to unusual pressure on the disbursement process, geographical spread of payment sites, complexity of legislation, use of discretion in decision-making, and political and public sensitivity.
Capability of Personnel	Personnel has the appropriate level, experience, and quality of training for all personnel, specifically those responsible for making eligibility determinations or certifying the accuracy of payments.

Table 1.2: Payment Inventory

Fund	Payments	Improper Payment[4]
609g	$ 10,924,946	$ 19,938.00
Administrative	58,808,185	14,598.49
Audit	3,212,172	0.00
CIF	13,272,544	4,673.00
Compact	549,652,511	0.00
Due Diligence	45,582,922	0.00
614G[5]	0.00	0.00
Threshold	3,613,017	0.00
Total	**$ 685,066,296**	**$ 39,209.49**

Based on the risk assessment for each fund, the Compact fund exhibited a higher risk of improper payments. However, no funds, including the Compact fund, met the OMB threshold of susceptibility to significant improper payments, defined as gross annual improper payments (i.e., the total amount of overpayments plus underpayments) in the program exceeding (1) both 1.5% of program outlays and $10,000,000 of all program or activity payments made during the FY, or (2) $100,000,000 (regardless of the improper payment percentage of total program outlays). Although MCC is not required to perform statistical sampling and estimation based on this information, MCC elected to perform it as detailed below to establish a baseline for future years.

II. Sampling and Estimation

MCC conducted statistical sampling of all funds and tested the selected sample to determine if the agency could identify any significant improper payments. The FY 2016 sampling and estimation plan was updated from the previous year to include disbursements made from all MCC funds for statistical sampling and subsequent determination of an improper payment rate. The scope of the sampling and testing efforts covered the period from July 1, 2015 to June 30, 2016, and included all funds and related activities administered by the MCC.

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 plus or minus 2.5 percent around the estimate of the percentage of improper payments.
- Select a sample from all disbursement transactions, excluding intragovernmental payments, and compose the population so that each item had an opportunity for selection.
- Select a representative sample 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 underpayments [i.e., not the net of over and under payments]).

MCC utilized a stratified random sample design. The population data was divided into groups, or strata, and each stratum was sampled separately, with different sampling rates to increase the efficiency of the design. During estimation, the sample is appropriately weighted to reflect the sampling rates for the different strata. The design variable was an individual invoice's amount. The final sample design is shown in Table 1.3.

For each selected sample, testing was conducted to validate that all payments were made in the correct amount under statutory, contractual, administrative, or other legally applicable requirements. A review of supporting documentation was conducted to verify the validity of each payment. Documentation reviewed included vendor submitted invoices, approval forms,

[4] This column represents actual identified improper payments for the assessment period of July 1, 2015 to June 30, 2016. These improper payment amounts are not based on the Appendix C statistical testing.

[5] The 614G fund was apportioned $151 thousand in FY 2016, but did not have payments during the assessment period.

Table 1.3: Sample Design					
Stratum Number	Stratum Definition	Population Size	Population Amount	Sample Size	Sample Amount
1	$0 to $16,618.99	12,619	$ 26,750,316	9	$ 22,657
2	$16,619 to $94,872.99	1,557	68,269,985	9	391,983
3	$94,873 to $249,923.99	609	95,409,932	9	1,501,893
4	$249,924 to $553,733.00	282	102,207,556	9	2,770,384
5	$553,734 to $1,342,159.99	122	97,239,031	9	6,752,685
6	$1,342,160 to $2,743,159.99	58	107,104,113	9	15,701,070
7	$2,743,160 to $4,999,999.99	29	109,584,921	9	34,416,677
8	$5,000,000 and above	9	61,311,356	9	61,311,356
Total		**15,285**	**$ 667,877,210**	**72**	**$ 122,868,705**

system reports, etc. Test results did not identify any improper payment amounts in the sample.

III. Improper Payment Reporting

This section is not applicable. OMB has not deemed MCC funds as susceptible to significant improper payments. Additionally, 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 conducted statistical sampling and testing to determine if the agency could identify any significant improper payments. MCC did not identify any improper payments from the sample of disbursements tested.

IV. Improper Payment Root Cause Categories

This section is not applicable. Based on OMB Circular No. A-123, Appendix C, Part I.A.9 Step 2, or Part I.A.14, MCC programs were not determined to be susceptible to significant erroneous payments.

V. Improper Payment Corrective Actions

This section is not applicable. Based on OMB Circular No. A-123, Appendix C, Part I.A.9 Step 2, MCC programs were not determined to be susceptible to significant erroneous payments.

VI. Internal Control Over Payments

This section is not applicable. Based on OMB Circular No. A-123, Appendix C, Part I.A.9 Step 2, MCC programs were not determined to be susceptible to significant erroneous payments.

VII. Accountability

This section is not applicable. Based on OMB Circular No. A-123, Appendix C, Part I.A.9 Step 2, MCC programs were not determined to be susceptible to significant erroneous payments.

VIII. Agency Information Systems and Other Infrastructure

This section is not applicable. Based on OMB Circular No. A-123, Appendix C, Part I.A.9 Step 2, MCC programs were not determined to be susceptible to significant erroneous payments.

IX. Barriers

This section is not applicable. Based on OMB Circular No. A-123, Appendix C, Part I.A.9 Step 2, MCC programs were not determined to be susceptible to significant erroneous payments.

X. Recapture of Improper Payment Reporting

OMB Circular No. A-123, Appendix C, Part 1, Section D requires agencies to have a cost-effective program of internal control to prevent, detect, and recover overpayments. For agencies that have programs and activities that expend more than $1 million in a FY, a payment recapture audit program is a required element of their internal controls over payments if conducting such audits is cost-effective. However, MCC determined that the recapture audits would not be cost-effective due to past improper payment rates and amounts for all funds (see the list of funds in Table 1.2). MCC analyzed known improper payments from the period of FY 2010–2014 and noted that the percentage of improper payments in comparison to total disbursements is 0.08 percent. OMB concurred with this opinion in July 2015. In FY 2016, MCC reviewed the testing results in the FY 2015 AFR and noted that significant changes did not occur since the initial analysis in July 2015.

MCC occasionally identifies improper payments outside of the Appendix C testing and estimation process, and formal recapture audits. In these instances, MCC pursues recapture of overpayments appropriately. Below is a summary and outcome of self-identified improper payments and recovery efforts:

- **USAID OIG Questioned Costs** — MCC Management successfully recaptured $24,611 in questioned costs previously identified through USAID OIG audits. These amounts are identified in the CIF and 609G Fund line items in Table 4.
- **Overseas Payroll Calculations** — MCC performed an analysis of overseas payroll disbursements during FY 2016 and self-identified gross improper payments of $411,917.38 beginning in FY 2012 through FY 2015. The amount of $10,662.02 occurred during the Appendix C Review Period and is identified in the Administrative Fund Line Item in Table 1.2. The cumulative overpayment amount beginning in FY 2012 is $402,401.38. MCC plans to recapture the full portion of overpayments related to the Overseas Payroll Calculations during FY 2017 and has set up a receivable to collect the balance
- Erroneous Payments — MCC self-identified a total amount of $2,715,551.57 in improper payments due to duplicate payments processed by MCC's financial service provider after the Appendix C Review Period, which is not illustrated in Table 1.2. There was also an overpayment included in the total due to an administrative error. MCC has recovered the entire $2,715,551.57 amount. The erroneous payments are listed in the Administrative, CIF, Compact, Due Diligence, and PEPFAR line items in Table 4.

Table 4: Overpayments Recaptured Outside of Payment Recapture Audits[6]

Fund	Amount Identified	Amount Recaptured
609g	$ 19,938.00	$ 19,938.00
Administrative[7]	494,445.01	89,988.05
Audit	0.00	0.00
CIF	351,511.92	351,511.92
Compact	1,912,074.26	1,912,074.26
Due Diligence	362,064.42	362,064.42
614G	0.00	0.00
Threshold	0.00	0.00
PEPFAR8	4,585.92	4,585.92
Total Payments	**$ 3,144,619.53**	**$ 2,740,162.57**

XI. Additional Comments

MCC has taken necessary steps to ensure the accuracy and integrity of Federal payments. Generally speaking, MCC has program integrity activities that fall into three basic categories: prevention, detection, and recovery. MCC will continue to monitor payments and take appropriate corrective actions for any improper payments that may be identified in the future.

Table 7. Results of the DNP Initiative in Preventing Improper Payments ($ in millions)						
	Number (#) of payments reviewed for possible improper payments	Dollars ($) of payments reviewed for possible improper payments	Number (#) of payments stopped	Dollars ($) of payments stopped	Number (#) of potential improper payments reviewed and determined to be accurate	Dollars ($) of potential improper payments reviewed and determined to be accurate
Reviews with the Do Not Pay databases	6,705	$135.81	0	$0.00	0	0
Reviews with databases not listed in IPERIA as Do Not Pay Databases	0	$0.00	0	$0.00	0	0

XII. Agency Reduction of Improper Payments with the Do Not Pay (DNP) Initiative

Processing payments accurately and timely is a top priority for MCC. The Contracts and Grants Management Division strictly adheres to the Federal Acquisition Regulations and ensures potential MCC vendors are registered in the System Acquisition Management (SAM), are not on the excluded party listing, and are not prohibited from competing for Federal government acquisitions. MCC's financial service provider, IBC, checks and verifies vendors' information before entering MCC vendor data into the core financial management system (Oracle) and before issuing payments. IBC issued a total of 6,705 payments to MCC local and foreign vendors during FY 2016. IBC has developed a custom process to house the results of the Do Not Pay Continuous Monitoring data. MCC participates in that process and uses Oracle Discoverer to retrieve the results of these monitoring activities.

Prior to submitting an Oracle Vendor request form to IBC, MCC Contracts and Grants Management division ensures that the vendor is not listed on the Do Not Pay listing.

MCC works diligently with its financial service provider to maintain oversight of payments. MCC adjudicated those payments monthly on the DNP portal and researched all matches or flags for any probable or possible improper payments. During FY 2016, MCC issued no stop payment orders and the Treasury DNP system did not report any payments with matches either through the Death Master File (DMF) or the SAM. In August and September 2016, DNP provided a listing of unmatched payments, which were payments that Treasury could not match to the DMF or SAM. In those instances, MCC investigated through the DNP Discoverer application within Oracle to verify the payments before adjudicating the monthly report on the DNP Portal.

[6] *According to OMB Circular A-136, section II.5.8, the order of the sections and the table numbers should be replicated in the IPIA Reporting Details section of the AFR. As a result, tables 1-3 and 5-6 referenced in the guidance were not applicable to MCC. However, Table 4 related to Overpayments Recaptured Outside of Payment Recapture Audits is documented on this page, and Table 7 is documented on the following page.*

[7] *The Administrative Fund contained overpayments related to prompt pay interest which cannot be recovered in the amount of $2,055.58. All other overpayments resulting from the overseas payroll calculations will be recovered in FY 2017.*

[8] *MCC disclosed the PEPFAR payment because it is in a parent/child relationship. The amount resulted from a duplicate payment processed by MCC's Financial Service Provider. The amount was fully recovered.*

Appendix

Appendix A: Acronyms

Acronym	Definition
AFR	Agency Financial Report
APR	Annual Performance Report
CBJ	Congressional Budget Justification
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIF	Compact Implementation Fund
CIO	Chief Information Officer
CPA	Certified Public Accountant
CSRS	Civil Service Retirement System
DMF	Death Master File
DNP	Do Not Pay
DOL	Department of Labor
DOT	Department of Transportation
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
FMFIA	Federal Managers Financial Integrity Act
FTE	Full-time Equivalent
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
IAA	Interagency Agreement
IAF	Inter-American Foundation
IBC	Interior Business Center
IG	Inspector General
IPERA	Improper Payments Elimination and Recovery Act
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPIA	Improper Payments Information Act
IT	Information Technology
M&E	Monitoring and Evaluation
MCA	Millennium Challenge Account
MCC	Millennium Challenge Corporation
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPIC	Overseas Private Investment Corporation

Acronym	Definition
OPM	Office of Personnel Management
PEPFAR	President's Emergency Plan for AIDS relief
PII	Personally Identifiable Information
PL	Public Law
PP&E	Property, Plant, and Equipment
SAM	System Acquisition Management
SF	Standard Form
SFFAS	Statement of Federal Financial Accounting Standards
SOS	Schedule of Spending
SSAE	Statement on Standards for Attestation Engagements
TSP	Thrift Savings Plan
UMIC	Upper-Middle Income
USADF	United States African Development Foundation
USAID	United States Agency for International Development
U.S.C	United States Code
USD	United States Dollars
USG	United States Government

MCC Welcomes Your Comments

MCC welcomes comments and suggestions regarding this report.

Please contact MCC at:

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