

The seal of the Office of the Special Inspector General for Iraq Reconstruction is a large, circular emblem in the background. It features a central eagle with wings spread, holding an olive branch and arrows. The eagle is superimposed on a shield with vertical stripes. The seal is surrounded by text in both English and Arabic. The English text reads "INSPECTOR GENERAL" at the top and "RECONSTRUCTION" at the bottom. The Arabic text reads "مفتش العام" at the top and "إعادة إعمار العراق" at the bottom.

REVIEW OF IRAQ RELIEF AND
RECONSTRUCTION FUND
UNMATCHED DISBURSEMENTS AT
THE DEPARTMENT OF STATE

SIGIR-07-012
APRIL 26, 2007



SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

April 26, 2007

MEMORANDUM FOR U.S. AMBASSADOR TO IRAQ
ASSISTANT SECRETARY FOR RESOURCE MANAGEMENT
AND CHIEF FINANCIAL OFFICER, BUREAU OF
RESOURCE MANAGEMENT, DEPARTMENT OF STATE
DIRECTOR, IRAQ RECONSTRUCTION MANAGEMENT
OFFICE

SUBJECT: Review of Iraq Relief and Reconstruction Fund Unmatched Disbursements at the Department of State (SIGIR-07-012)

This report discusses the results of the Special Inspector General for Iraq Reconstruction (SIGIR) review of internal controls over disbursements of Iraq Relief and Reconstruction Funds (IRRF) apportioned to the Department of State (DoS). On January 30, 2007, we reported the results of our reviews of internal controls related to disbursements of IRRF funds at the Department of Defense (DoD) and the U.S. Agency for International Development (USAID).¹ At that time, we announced that a separate audit of unmatched disbursements at DoS would be performed due to the lack of access to data needed for our initial review, which included DoS. These are the results of our separate audit.

Summary

DoS has adequate internal controls to minimize the occurrence of unmatched disbursements of IRRF funds. We tested DoS's internal controls for a sample of the approximately \$1.6 billion in funds obligated, and \$1.3 billion in funds disbursed, as of September 30, 2006. In general, we found, that IRRF obligations and disbursements recorded in DoS's accounting system were supported by proper documentation; and that disbursements could be properly matched to existing obligations.

¹ *Review of Iraq Relief and Reconstruction Fund Unmatched Disbursements* (SIGIR-06-043, January 30, 2007).

Objectives

This review was initially announced on July 21, 2006,² with the overall objectives to determine the amount of IRRF unmatched disbursements and whether U.S. government agencies have established adequate management controls over IRRF unmatched disbursements. To accomplish these objectives, we addressed the following questions:

- How much IRRF monies have been identified as unmatched disbursements?
- How often are unmatched disbursements reviewed by government officials, and who makes the determination that the disbursement was an IRRF expenditure?
- Have IRRF unmatched disbursements subsequently been identified to other IRRF projects?
- What management controls are in place to eliminate and resolve unmatched disbursements?

Due to the lack of access to data needed for our initial review, we re-announced a separate review of DoS's unmatched disbursements in our January 30, 2007, report.

Background

The *Emergency Wartime Supplemental Appropriations Act*, Public Law 108-11, created the Iraq Relief and Reconstruction Fund (referred to as IRRF 1) and appropriated approximately \$2.5 billion to be used in Iraq for a broad range of humanitarian and reconstruction activities by USAID, DoD, DoS, the Department of the Treasury, and the Department of Health and Human Services. The *Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan*, Public Law 108-106, appropriated an additional \$18.4 billion (referred to as IRRF 2) for the rebuilding of Iraq. As of September 30, 2006, DoS was apportioned \$1.7 billion of IRRF appropriated funds—\$100.7 million in IRRF 1 funds and about \$1.6 billion in IRRF 2 funds.

Internal controls represent an organization's plans, methods, and procedures to meet its missions, goals, and objectives and serve as the first line of defense in safeguarding assets and preventing and detecting errors, fraud, waste, abuse, and mismanagement. Internal controls over disbursements include the policies, procedures, and management controls to ensure contractor invoices are not paid unless the invoices can be matched to obligations in the organization's accounting system.³ Disbursements must be matched with corresponding obligations in official accounting records to ensure that funds are spent in accordance with the purposes and limitations set by Congress and to avoid fraudulent disbursements or erroneous payments.

² SIGIR initially announced this audit (Project 6027) on July 21, 2006, for reviews at DoS, DoD, and USAID.

³ Invoices are bills submitted for payment. Disbursements are the payments.

An unmatched disbursement is a transaction that has been received and accepted by an accounting office, but has not been matched to the correct detail obligation.⁴ Unmatched disbursements not only affect reports prepared by an agency to monitor its obligations and expenditures of budgetary resources, but also its financial position and the results of its operations.

Results

DoS has adequate internal controls to minimize the occurrence of unmatched disbursements of IRRF 1 and 2 funds. As of September 30, 2006, DoS had obligated approximately \$1.6 billion and disbursed about \$1.3 billion in combined IRRF 1 and 2 funds. To test DoS's internal controls, we examined transaction level documentation for about 26% of these amounts—\$438.8 million in obligations and \$348.2 million in disbursements. We found that the obligations in DoS's accounting system were supported by proper documentation and were posted (existed) prior to the disbursement of funds. Similarly, the disbursements were supported by proper documentation and agreed with the entries posted in the accounting system. As a result, we could match the recorded disbursements with the corresponding recorded obligations.

However, some records we requested were not provided for our review. DoS could not provide obligating documents supporting \$5.7 million of the obligations (1% of our sample dollar value) which related to \$13.3 million of the disbursements (4% of our sample dollar value) for transactions posted to the accounting system. As such, we could not verify whether unmatched disbursements may have occurred relating to these transactions. However, we consider those amounts to be immaterial to the results of our analysis. Based on our review, we conclude that adequate management controls exist to minimize the occurrence of unmatched disbursements.

DoS Management Controls

Although DoS does not have a formal definition for unmatched disbursements, its budgetary and financial management policy directives and required procedures relating to detecting them are in its Foreign Affairs Manual, 4 FAM, "Financial Management" and its Foreign Affairs Handbook, 4 FAH-3, "Financial Management Procedures Handbook." The Foreign Affairs Manual provides that the general rule for lawfully obligating funds is that the items or services ordered must fill a bona fide need for the fiscal year in which the purchase or service is established, and that the obligation is not incurred at a date earlier than is necessary for the successful conduct of the Government's business. The "Financial Management Procedures Handbook" requires that prior to payment (disbursement); the invoice examiner should determine that: the invoice is for a valid obligation; the information on the payment voucher and supporting documentation is proper and correct; and the obligation against which

⁴ For purpose of our analysis, we used the Department of Defense definition because DoS does not have a formal definition of unmatched disbursements in its financial management policies or procedures. This definition is contained in the Department of Defense Financial Management Regulation, Volume 3, Chapter 11. According to the DoS Director, Financial Reporting and Analysis, a program office rather than an accounting office accepts the transaction, but the Department of Defense definition is otherwise applicable.

payment will be made has an adequate unexpended balance to cover the payment. The “Financial Management Procedures Handbook” further provides that if the invoice contains errors or is incomplete, the respective vendor should be notified and provided an opportunity to correct the invoice. According to the DoS Deputy Chief Financial Officer, these procedures are a key management control to prevent improper or incomplete invoices from being entered into the accounting system and paid, thus creating an unmatched disbursement. These procedures also ensure there is a complete invoice that is properly linked to a valid pre-existing obligation.

DoS’s Internal Analysis of Unmatched Disbursements

We reported on January 30, 2007, that we were unable to assess DoS’s internal controls because DoS officials did not provide access to detailed IRRF obligation and disbursement data needed for our initial audit of unmatched disbursements. Rather, on December 13, 2006, DoS provided us with the results of its own, one-time analysis of IRRF disbursements that they performed in response to our initial audit. DoS identified \$60,113 of unmatched disbursements that occurred between August 2004 and December 2005 from total IRRF disbursements of \$1.3 billion made from fiscal year 2004 through September 30, 2006.

We further reported on January 30, 2007, that because DoS did not provide us with a detailed listing of its obligations to compare with its disbursements, we could not independently validate the reasonableness of the unmatched disbursements data or the effectiveness of DoS’s policies, procedures, and practices regarding controls over disbursements during our initial audit.

We did not review or validate DoS’s methodology for conducting its internal analysis for unmatched IRRF disbursements, which covered the period fiscal year 2004 through September 30, 2006. Our review of DoS’s supporting documentation for its internal audit, determined that the unmatched disbursements DoS identified related to three payroll transactions totaling \$7,084⁵ that occurred in August 2004 and October 2005, and nine other transactions totaling \$53,029⁶ that occurred between September 2004 and December 2005. The three payroll transactions were identified by DoS as a failure of the DoS to establish in advance obligations for travel expenses for one DoS employee. DoS similarly found that the unmatched disbursements involving the nine other transactions were the result of a failure of the DoS program office to obligate sufficient funds before paying the vendor invoices. Specifically, DoS’s analysis indicated that there was a failure to ensure that sufficient funds were obligated before payment. According to the DoS Deputy Chief Financial Officer, no corrective actions were taken to change their procedures because the amounts involved were small. However, he said that DoS will be implementing a new accounting system in May 2007 that will have improved controls that should prevent similar unmatched disbursements in the future.

⁵ The three transactions were for \$69.27, \$2,712.84, and \$4,301.86.

⁶ The amounts involved ranged from \$8.29 to \$21,598.88.

Recommendation

Because we found that DoS has adequate management controls to minimize the occurrence of unmatched disbursements for IRRF funds, we make no recommendations.

Scope and Methodology

This review (Project No. 7002) had the overall objective of determining whether DoS had established adequate internal controls to identify, review, resolve, and eliminate IRRF unmatched disbursements.

To identify and assess the adequacy of management controls over IRRF disbursements, we reviewed pertinent sections of the DoS Foreign Affairs Manual and Foreign Affairs Handbook, which contain the written policies and procedures used to establish obligations and match disbursements with the appropriate obligation. We discussed these policies, procedures, and the management controls intended to prevent unmatched disbursements with the DoS Deputy Chief Financial Officer and his staff.

To determine the adequacy of controls to prevent unmatched disbursements, we tested the procedures by determining whether selected obligations were recorded; disbursement documents were in agreement with the accounting records; and disbursements could be matched with pre-existing obligations. We obtained a sample of obligation and related disbursement transaction documents to determine whether the obligations and the related transaction amounts recorded in the accounting records were properly supported. While there were delays in receiving the documents, this seemed to be due to the decentralization of transactional-level records that are maintained by each Bureau and not directly accessible by the Deputy Chief Financial Officer or his staff.

To test the DoS controls, we took the following actions:

1. At our request DoS prepared and we reviewed a financial report listing⁷ of all IRRF 1 and IRRF 2 obligations and disbursements made through September 30, 2006. According to these reports, DoS had obligated \$1.657 billion and disbursed \$1.341 billion, as shown in Table 1.

⁷ According to the DoS Deputy Chief Financial Officer, at the time of our request the standard financial reports for prior fiscal years had been archived and were not readily available, leading to preparation of this financial report of IRRF transactions.

**Table 1. IRRF Obligations and Disbursements as of September 30, 2006
(Dollars in Billions)**

Fund	Obligations	Disbursements
IRRF 1	\$0.101	\$0.088
IRRF 2	\$1.557	\$1.253
TOTAL	\$1.657	\$1.341

Note: Totals may not add due to rounding.

Source: Developed by SIGIR from DoS financial report listing of all IRRF 1 and IRRF 2 obligations and disbursements made through September 30, 2006 obtained from the DoS Director, Financial Reporting and Analysis.

2. We judgmentally selected 107 documents for review from the financial report listing of all IRRF 1 and IRRF 2 obligations and disbursements made through September 30, 2006—26 IRRF obligation entries amounting to \$444.7 million and 81 disbursement transactions amounting to \$348.2 million—which cover the three major types of DoS Bureau actions: contracts, interagency agreements, and grants (*see Tables 2 and 3*). The obligations in our sample ranged from \$164,852 to \$165,000,000. The disbursements in our sample ranged from \$59 to \$39,784,746. Transactions selected for review were included in the financial report discussed above. We judgmentally selected disbursement transactions that included each major type of obligation entered into by DoS. Between February 8, 2007 and March 26, 2007, DoS provided us with 105 of the 107 supporting documents we requested, that represented 99% of obligations and 100% of disbursements in our sample. Based on our examination, DoS has adequate controls to minimize the occurrence of unmatched disbursements. Although DoS did not provide documents for two of the obligations we selected for review, with a combined value of \$5.7 million; those documents represented only 1% of the obligations in the sample. Therefore, we do not believe that they would have materially affected our analysis and conclusions. The two obligation documents also related to eight disbursements we reviewed totaling \$13.3 million, or 4%. Thus, while we were able to compare documents for the eight disbursement transactions to the accounting records and verify that they were recorded accurately, we were not able to verify that the disbursements were recorded against pre-existing obligations.

We used a judgmental sample intended to cover a significant amount of the IRRF disbursement dollars as well as the major transaction types: contracts, interagency agreements, and grants. We analyzed obligation and disbursement data to determine whether disbursements could be matched to obligations (*see Table 2*). All 81 disbursement documents we examined contained an obligation number that could be matched to obligation references in accounting records.

Table 2. Number of Transactions Reviewed

Transaction Type	IRRF 1		IRRF 2		Total IRRF 1 and 2	
	Obligations	Disbursements	Obligations	Disbursements	Obligations	Disbursements
Contracts	5	11	6	20	11	31
Interagency Agreements	2	15	9	32	11	47
Grants	0	0	2	3	2	3
TOTAL	7	26	17	55	24	81

Source: Developed by SIGIR from DoS financial report listing of all IRRF 1 and IRRF 2 obligations and disbursements made through September 30, 2006.

Table 3. Amount of Transactions Reviewed (Dollars in Millions)

Transaction Type	IRRF 1		IRRF 2		Total IRRF 1 and 2	
	Obligations	Disbursements	Obligations	Disbursements	Obligations	Disbursements
Contracts	\$42.6	\$18.0	\$197.4	\$185.1	\$240.0	\$203.1
Interagency Agreements	29.8	35.8	160.7	108.0	190.5	143.8
Grants	0	0	8.3	1.3	8.3	1.3
TOTAL	\$72.4	\$53.8	\$366.4	\$294.4	\$438.8	\$348.2

Source: Developed by SIGIR from DoS financial report listing of all IRRF 1 and IRRF 2 obligations and disbursements made through September 30, 2006.

3. We requested and reviewed contract, grant, and interagency agreement files maintained by the DoS Office of Acquisition Management and three Bureaus that made grants and entered into interagency agreements using IRRF funds: the Bureau of Democracy, Human Rights and Labor; the Bureau of International Narcotics and Law Enforcement; and the Bureau of Population, Refugees and Migration. For each Bureau, we obtained and reviewed contracts, grants, and interagency agreements to identify their purpose and funds obligated.
4. We reviewed the DoS analysis of unmatched disbursements in which it identified \$60,113 of unmatched disbursements that occurred between August 2004 and December 2005 from total disbursements of \$1.3 billion made from fiscal year 2004 through September 30, 2006. These unmatched disbursements related to three payroll transactions totaling \$7,084 and nine other transactions totaling \$53,029. DoS provided documentation related to these unmatched disbursements, but we did not independently validate DoS's methodology or resulting analysis.
5. We reviewed the DoS *Performance and Accountability Report for Fiscal Year 2006*, to ascertain whether it identified weaknesses related to unmatched disbursement. Our review found that no concerns were raised specifically relating to unmatched disbursement. However, we did note that the financial section of this report—prepared by

an independent auditor—concluded that DoS’s financial and accounting system, as of September 30, 2006, was inadequate and that there was a risk of materially misstating financial information under current conditions. The auditor found weaknesses in internal controls that it discussed in the financial section of the DoS *Performance and Accountability Report for Fiscal Year 2006* including:

- security of information systems networks
- financial management system’s noncompliance with the requirements of the Federal Financial Management Improvement Act of 1996
- management of unliquidated obligations
- recording and related depreciation of real property
- implementation of Managerial Cost Accounting Standards

The Independent Auditor’s Report noted that, as of November 2006, DoS was unable to provide complete financial statements or respond to requests for evidential material in a timely manner. As a result, the independent auditor was not able to perform auditing procedures to satisfy itself as to the accuracy of the 2006 financial statements in time to meet a November 15, 2006, deadline imposed by the Office of Management and Budget.

Subsequently, on December 12, 2006, the independent auditor reported that the DoS provided adequate documentation to support the amounts reported on the financial statements, together with completed financial statements. The independent auditor further reported that it had satisfied itself that the amounts presented in DoS’s restated 2006 financial statements are presented fairly in all material respects in conformity with accounting principles generally accepted in the United States of America.

Use of Computer-Processed Data

To perform our audit, we used data from DoS’s automated accounting systems, which we did not independently audit. Aspects of these systems were reported as unreliable in the DoS *Performance and Accountability Report for Fiscal Year 2006*. We did not test any of the general and application controls of the automated systems we obtained data from. However, in determining data validity of the information we used from these systems, we compared selected accounting system information to selected source documents (including grant agreements, interagency agreements, contracts, and disbursement invoices). We found that the obligation and disbursement documents reviewed agreed with amounts recorded in the accounting system and that disbursements could be matched with pre-existing obligations. As a result of our comparison, we determined that the data was sufficiently reliable to accurately portray whether there were unmatched disbursement control issues.

Prior Coverage

We reviewed applicable reports issued by SIGIR and the U.S. Army Audit Agency:

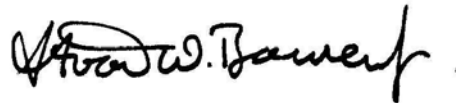
- *Review of Iraq Relief and Reconstruction Fund Unmatched Disbursement* (SIGIR-06-043, January 30, 2007)
- *Improper Obligations Using the Iraq Relief and Reconstruction Fund (IRRF 2)* (SIGIR-06-040, January 30, 2007)
- *Review of Administrative Task Orders for Iraq Reconstruction Contracts* (SIGIR-06-028, October 23, 2006)
- *Interim Audit Report on Improper Obligations Using the Iraq Relief and Reconstruction Fund 2* (SIGIR-06-037, September 22, 2006)
- *Fund Accountability for Fiscal Year 2004 Iraq Relief and Reconstruction Funds* (U.S. Army Audit Agency-A-2006-0046-ALA, January 31, 2006)

We performed this review from October 2006 through April 2007 in accordance with generally accepted government auditing standards.

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This report is provided for your information and use. This report does not contain any recommendations. On April 19, 2007, we discussed and coordinated the content and facts in this report with the DoS Deputy Chief Financial Officer. As agreed at this meeting, management comments are not required or expected.

We appreciate the courtesies extended to the staff. For additional information on this report, please contact Mr. Joseph T. McDermott (703-428-1100 / joseph.mcdermott@sigir.mil); or Mr. Steven H. Sternlieb (703-428-0240 / steven.sternlieb@sigir.mil). For the report distribution, see Appendix A. For a list of the audit team members, see Appendix B.



Stuart W. Bowen, Jr.
Special Inspector General for Iraq Reconstruction

cc: See Distribution

Appendix A. Report Distribution

Department of State

Secretary of State

Senior Advisor to the Secretary and Coordinator for Iraq

Director of U.S. Foreign Assistance/Administrator, U.S. Agency for International Development

Director, Office of Iraq Reconstruction

Assistant Secretary for Resource Management/Chief Financial Officer, Bureau of Resource Management*

U.S. Ambassador to Iraq

Director, Iraq Reconstruction Management Office

Mission Director-Iraq, U.S. Agency for International Development

Inspector General, Department of State

Department of Defense

Secretary of Defense

Deputy Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer

Deputy Chief Financial Officer

Deputy Comptroller (Program/Budget)

Deputy Assistant Secretary of Defense-Middle East, Office of Policy/International Security Affairs

Inspector General, Department of Defense

Director, Defense Contract Audit Agency

Director, Defense Finance and Accounting Service

Director, Defense Contract Management Agency

Department of the Army

Assistant Secretary of the Army for Acquisition, Logistics, and Technology

Principal Deputy to the Assistant Secretary of the Army for Acquisition, Logistics, and Technology

Deputy Assistant Secretary of the Army (Policy and Procurement)

Director, Project and Contracting Office

Commanding General, Joint Contracting Command-Iraq/Afghanistan

Assistant Secretary of the Army for Financial Management and Comptroller

Chief of Engineers and Commander, U.S. Army Corps of Engineers

Commanding General, Gulf Region Division

Chief Financial Officer, U.S. Army Corps of Engineers

Auditor General of the Army

U.S. Central Command

Commanding General, Multi-National Force-Iraq

Commanding General, Multi-National Corps-Iraq

Commanding General, Multi-National Security Transition Command-Iraq

Commander, Joint Area Support Group-Central

*Recipient of the draft audit report

Other Federal Government Organizations

Director, Office of Management and Budget
Comptroller General of the United States
Inspector General, Department of the Treasury
Inspector General, Department of Commerce
Inspector General, Department of Health and Human Services
Inspector General, U.S. Agency for International Development
President, Overseas Private Investment Corporation
President, U.S. Institute for Peace

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

U.S. Senate

Senate Committee on Appropriations
 Subcommittee on Defense
 Subcommittee on State, Foreign Operations and Related Programs
Senate Committee on Armed Services
Senate Committee on Foreign Relations
 Subcommittee on International Operations and Organizations, Democracy and Human Rights
 Subcommittee on International Development and Foreign Assistance, Economic Affairs and International Environmental Protection
 Subcommittee on Near East and South and Central Asian Affairs
Senate Committee on Homeland Security and Governmental Affairs
 Subcommittee on Federal Financial Management, Government Information, Federal Services and International Security
 Permanent Subcommittee on Investigations
 Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia

U.S. House of Representatives

House Committee on Appropriations
 Subcommittee on Defense
 Subcommittee on State, Foreign Operations, and Related Programs
House Committee on Armed Services
House Committee on Oversight and Government Reform
 Subcommittee on Government Management, Organization, and Procurement
 Subcommittee on National Security and Foreign Affairs
House Committee on Foreign Affairs
 Subcommittee on Middle East and South Asia
 Subcommittee on International Organizations, Human Rights, and Oversight

Appendix B. Audit Team Members

This report was prepared and the audit work was conducted under the direction of Joseph T. McDermott, the Assistant Inspector General for Audit, Office of the Special Inspector General for Iraq Reconstruction.

The staff members who conducted the audit and contributed to the report include:

Karen D. Bell

Shawn D. Kline

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Richard P. McVay

Robert L. Pelletier

Steven H. Sternlieb

Charles W. Thompson

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