SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

April 30, 2012

LETTER FOR U.S. SECRETARY OF STATE
        U.S. AMBASSADOR TO IRAQ

SUBJECT: Interim Review of State Department's Progress in Implementing SIGIR Recommendations Addressing Quick Response Fund Management Controls (SIGIR 12-016)

This letter addresses the Special Inspector General for Iraq Reconstruction's (SIGIR) review of the Department of State's (DoS) progress in implementing SIGIR recommendations in its April 27, 2011 audit report of the Quick Response Fund (QRF) program.[1] In that report, we found that recordkeeping for projects from 2007-2008 was poor and that many of the available files did not contain documentation on project outcomes and the use of funds. Without documentation and importantly, an analysis of those documents, we concluded that DoS cannot be assured that these projects were completed or that the funds were not lost or stolen. We made recommendations to address these deficiencies. The objective of this follow-up audit, therefore, was to determine the extent to which SIGIR's recommendations to address these serious problems have been implemented.

Officials from the DoS Bureau of Near Eastern Affairs (NEA) stated that they found most of the documents SIGIR previously reported were missing and entered them into its QRF project tracking database. In particular, they said that they reviewed vouchers and concluded that the vouchers appeared to be complete and certified by a US government officer. Furthermore, NEA officials noted that while reviewing the vouchers, they did not see indications that would have led them to believe that the certified vouchers represented fraudulent transactions.

However, NEA officials did not directly address the specific instances of possible fraudulent activity that SIGIR noted in its April 2011 report.[2] (These examples are described in more detail below.) Because those projects were micro-purchases that involved cash and, at that time, did not have supporting documentation showing how the cash was spent or how the projects were completed, SIGIR believes a detailed analysis of those projects is needed. As such, this is an interim report, and SIGIR will continue with this audit and examine the extent and thoroughness of the documentation of outcomes and use of funds for those and other QRF projects initiated between 2007 and 2008.

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[1] See *Quick Response Fund: Management Controls Have Improved, but Earlier Projects Need Attention,* SIGIR 11-011, 4/27/ 2011.

[2] One example pertains to a soccer field restoration project in Ninewa province. Seven other projects are also discussed in the report. A discussion of those projects is found in *Quick Response Fund: Management Controls Have Improved, but Earlier Projects Need Attention,* SIGIR 11-011, 4/27/ 2011, pp. 19-21.

Background

In August 2007, DoS established the QRF program to provide Provincial Reconstruction Teams (PRT) with a flexible means to fund local projects that would promote economic and social development in Iraq. The QRF program, which has ended in Iraq, fell under the Economic Support Fund authority. QRF funds, often in the form of cash, were provided through grants, micro-grants, direct procurements, and micro-purchases of materials—such as seed, fertilizer, or books—to local neighborhood and government officials and to members of community-based groups, such as nonprofit organizations, business and professional associations, charities, and educational institutions. DoS had overall responsibility for the QRF program, but implementation was divided between DoS and the U.S. Agency for International Development (USAID).[3] About $258.2 million from the Economic Support Fund was allocated to fund the QRF program; DoS managed about $125.1 million while USAID managed about $133.1 million.[4]

DoS developed its QRF tracking database in early 2008 to help manage and oversee all QRF projects. The database subsequently expanded to encompass a range of documents to include soliciting proposals, payment documentation, and award results. According to DoS, the database serves as the official records management platform for the QRF program.

SIGIR's Prior QRF Review Raised Serious Concerns of Possible Fraud

SIGIR has conducted two reviews of the QRF program, in addition to two other DoS-sponsored assessments.[5] In our January 2009 report, we examined management controls over program implementation and noted weaknesses in DoS's monitoring, evaluating, and project documenting processes. In our April 2011 report, we found that while DoS improved management controls over the program, project documentation was still lacking. Specifically, SIGIR noted that while most files of projects initiated since January 2009 contained key documents, many files of projects initiated in 2007 and 2008 did not. In particular, SIGIR's review of 159 QRF projects initiated in 2007 and 2008 found that many of the files lacked documents such as project outcomes, invoices and receipts, and purchase orders. Absent this information, SIGIR concluded that DoS cannot be assured that projects were completed or that the funds were not lost or stolen.

Beyond missing documentation, SIGIR's review of 2007-2008 projects also raised serious questions about possible fraudulent activity based on documents that were in the files. In one example, we found the file of one $24,830 project to refurbish a soccer field contained a note from the Iraqi project manager stating that he had never received any money from the PRT. Yet, documentation showed that the money had been provided to him. The project was never completed, and there were no invoices or receipts to account for the money. Additional documents in the file showed that a PRT official removed the soccer field restoration money from the PRT safe, but no documents in the file showed what had been done with the money.

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[3] DoS implemented small projects costing up to $25,000 while USAID implemented larger, more costly projects.
[4] According to NEA officials, these amounts reflect the most current and available data on QRF expenditures.
[5] See *Opportunities To Improve Management of the Quick Response Fund*, SIGIR 09-011, 01/29/2009. See also *Review of the U.S. Department of State's Quick Response Fund (QRF) Program*, Management Systems International, 04/2009, and *Review of the QRF Program*, Department of State, Office of the Procurement Executive and Near Eastern Affairs/Iraq/Economic Assistance, 03/2008.

Despite this, nothing in the file indicated that any actions were taken to determine what had happened to the QRF funds. A review of seven other projects that totaled $140,980 also revealed that they all lacked invoices and receipts. We did not conclude that fraud had occurred in those cases but referred them to SIGIR Investigations for follow-up.

In addition, our April 2011 QRF audit also found that one PRT official prematurely destroyed his QRF project files because he did not know what to do with them.

Recommendations Made To Improve QRF Accountability

To improve the accountability of the QRF program, SIGIR recommended that the Secretary of State direct responsible offices to perform the following:

1. Conduct an assessment of all [DoS-implemented] QRF projects initiated in 2007 and 2008 to determine if project outcomes are documented and whether funds can be accounted for.

2. Prepare a report for the Secretary on the assessment results and actions taken to address identified problems.

3. Ensure that the Office of Provincial Affairs and the PRTs understand and implement DoS records management policies and procedures and ensure that original [DoS-implemented] QRF records are preserved and maintained until the assessment is completed.[6]

DoS concurred with all three recommendations.

NEA Officials Stated They Found and Reviewed Missing Project Files

NEA officials stated that they found almost all missing project files and reviewed them for possible fraud. NEA officials also continue to state that the only documentation required during 2007 and 2008 was form SF44, a form that can be used to represent the purchase order, invoice, receiving report, and/or public voucher. Based on SIGIR's review, there is clear documentation showing that invoices and receipts were also required. Further, NEA officials did not review existing project files where SIGIR found significant indications of fraudulent activity.

In a written statement (which is presented in its entirety in Appendix B), NEA officials stated that they found all but 21 project files and entered them into the QRF tracking database. While entering them into the database, officials said that they reviewed vouchers and noted that they appeared to be complete and that there were no indications that would have led them to believe that the vouchers represented fraudulent transactions. Officials concluded that the QRF database now contains the required documentation and that relevant control procedures existing at the time were followed.

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[6] U.S. Embassy began the process of closing down the PRTs as part of the U.S. Government's plans for military withdrawal after the release of SIGIR's April 2011 QRF audit; all 14 PRTs were closed between April and September 2011. Since the PRTs are closed, this recommendation has been overtaken by events and is no longer relevant.

One of the relevant controls NEA officials noted was that the U.S. government Certifying Officer in Baghdad certified all vouchers before payments were made. NEA officials added that all payment requests required proper supporting documentation to enable the Certifying Officer to certify payment and that the certification process occurred independently of the PRT that implemented the project. However, SIGIR noted in its April 2011 report several cases where potential fraud may have occurred, despite the existence of this control.

In their written response, NEA officials also said that an SF44 form represents the purchase order, invoice, receiving report, and/or public voucher. In short, they believe that the SF44 form can be used to represent all of these individual pieces of information in one form, to include invoices. However, we noted in our April 2011 report that NEA's implementing guidance stated that "PRTs must maintain a copy of the SF-44…and vendor's invoice in the project file." Similarly, a QRF newsletter dated June 16, 2008, discussed how to make a cash payment for a micro-purchase. The newsletter made several points, including: "before disbursing funds, make sure that all parties sign the appropriate forms and invoices" and "all invoices and receipts must be originals." Our April 2011 report also stated that according to the Simplified Acquisition Regulation, invoices are required, and only the Department of State Office of the Procurement Executive can waive this requirement. NEA officials stated that the Office of Procurement Executive approved the SF44 form as the minimum requirement for projects implemented in 2007-2008.

SIGIR continues to believe that using form SF44 in lieu of invoices is inappropriate. When cash payments are made without invoices, the only control in place is the word of the project officer that a project was completed, and the money was spent appropriately. Because some of the projects we examined in our last QRF report showed significant indications of fraud and were missing invoices, we will re-examine their supporting documentation, to determine whether the projects were completed and how funds were used.

DoS Has Not Prepared Report to the Secretary of State

SIGIR's second recommendation from its 2011 audit asked that a report be prepared for the Secretary of State on the assessment results and actions taken to address identified problems. DoS officials stated that they have not prepared such a report but will prepare a briefing.

DoS Efforts To Strengthen Records Management

DoS informed us that it has taken steps to implement SIGIR's recommendations to improve its records management practices. Specifically, DoS provided two e-mail directives requiring staff to improve internal controls:

- In April 2011, a DoS email directed officials involved with managing the QRF program to refrain from destroying paper records until further notice.

- In May and June 2011, PRTs were directed, via email, to hold QRF records until the Office of Provincial Affairs officials could retrieve them.

Subsequent to the issuance of this records retention guidance, U.S. Embassy began the process of closing down the PRTs as part of the U.S. government's plans for military withdrawal. All 14 PRTs were closed between April and September 2011.

Conclusion

In the eight years that SIGIR has provided oversight over the U.S. government's efforts to reconstruct Iraq, we have often noted that a lack of documentation greatly impeded our ability to provide needed transparency over Iraq reconstruction funds. In numerous audits, we have also found that detailed analyses of documentation could uncover instances of fraud, waste, and abuse.

Because programs that involved the use of cash, such as the QRF program, are more susceptible to fraud, waste, and abuse, strong internal controls over program management and fund expenditures are needed. A detailed analysis of project documentation is necessary to provide insight on the strengths and weaknesses of these controls and to determine if there are other cases of potential fraud like SIGIR identified in its last report.

DoS's efforts to locate, review, and enter hundreds of project documents into the QRF database is a good first step and a prerequisite to assuring that there is a complete and accurate database to be used as a management and internal control tool. However, SIGIR's prior report found possible instances of fraud that warrants a closer review of documentation in the QRF database. Thus, SIGIR will continue with this audit and examine the extent and thoroughness that project outcomes and fund-use were documented for those projects that we noted may have contained fraudulent activities as well as other project files. We will also review a sample of project documentation that DoS has recently entered into their QRF database.

Management Comments and Audit Response

SIGIR received formal comments on this report, which are printed in their entirety in Appendix C. DoS reiterates that its use of the SF44 form to represent the purchase order, invoice, receiving report and/or public voucher was appropriate during the 2007-2008 timeframe as that was the only document required for micro-purchases. DoS further state that it shares SIGIR's concerns that all program documentation be as complete as possible; however, it based the standard of completeness on the requirements that were in place at the time of project implementation.

Despite repeated attempts at pointing out to DoS officials that their written guidance made specific references to the need for invoices and receiving documents, they continue to state that they are not required and that they obtained a waiver for these requirements. Even if these documents were not required, program managers need to understand that using one form that lacks the most fundamental of controls over a $125.1 million program is inappropriate and inadequate. In addition, DoS officials did not review the projects where SIGIR found significant indications of fraud. This is a serious oversight. As a result, SIGIR will conduct additional analysis of project documentation to ensure that funds were not subject to fraud, waste, and abuse.

We also received technical comments, which we incorporated where appropriate.

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We appreciate the courtesies extended to the SIGIR staff. For additional information on the report, please contact James Shafer, Assistant Inspector General for Audits, (703) 604-0894/ fred.j.shafer.civ@mail.mil, or Tinh Nguyen, Principal Deputy Assistant Inspector General for Audits, (703) 604-0545/ tinh.t.nguyen4.civ@mail.mil

Stuart W. Bowen, Jr.
Inspector General

Appendix A—Scope and Methodology

Scope and Methodology

This report reviews progress made by DoS on recommendations made in an April 2011 audit concerning the Department's management controls over its Quick Response Fund (QRF). This audit was performed under the authority of Public Law 108-106, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended. SIGIR conducted its review as Project 1203 from January 2012 to April 2012 in Arlington, Virginia.

To evaluate the progress made, we held discussions with DoS Bureau of Near Eastern Affairs/Iraq and Office of Provincial Affairs officials in Washington, D.C. to determine the status of their efforts to implement our recommendations made in a prior report. We subsequently reviewed the QRF assessment report that they provided as evidence of their efforts to implement our recommendations. Finally, we reviewed statements made by DoS officials regarding their review, location, and uploading of missing documentation in the QRF database.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Use of Computer-processed Data

We did not rely on computer-processed data in conducting this review. However, we based our statements on the contract assessment that used data from the DoS QRF tracking database.

Internal Controls

In conducting the review, we considered conclusions and comments in independent audit reports concerning the adequacy of DoS's internal controls over the DoS-managed portion of the QRF program. The reports we reviewed are listed below.

Prior Audit Coverage

We reviewed the following applicable audit and other reports issued by SIGIR, DoS, USAID, and Management Systems International.

Special Inspector General for Iraq Reconstruction

Quick Response Fund: Management Controls Have Improved, but Earlier Projects Need Attention, SIGIR 11-011, 04/27/2011.

Opportunities To Improve Management of the Quick Response Fund, SIGIR 09-011, 01/29/2009.

Department of State

Review of the QRF Program, Department of State, Office of the Procurement Executive and Near Eastern Affairs/Iraq/Economic Assistance, 03/2008.

Management Systems International

Review of the U.S. Department of State's Quick Response Fund (QRF) Program, Management Systems International, 04/2009.

Appendix B—DoS's Statements on Its Efforts to Implement SIGIR's Recommendations

United States Department of State

Washington, D.C.   20520

April 20, 2012

Quick Response Fund Program Assessment
Statement of Fact

As a part of our ongoing efforts to assess and enhance internal controls, the Embassy and NEA/I have continually looked for ways to strengthen the QRF Program over the last few years while it was in operation.   From the program's outset, in August of 2007, the Embassy and NEA/I have worked closely with the Office of the Procurement Executive to design, monitor and evaluate changes in order to strengthen internal controls over QRF funds in Iraq.

The most important enhancement of internal controls over the QRF program was the creation of the records management database in early 2008. Since the creation of the database, it has evolved over time to include soliciting proposals, tracking project evaluation / approvals, initiating and documenting payments and tracking award results. The database also serves as the official records management platform for QRF.

During the course of SIGIR's 2010/11 audit of the QRF program they sampled 20 micro-purchases (contained in Appendix E of SIGIR's April 2011 report) for 2007-2008. SIGIR further expanded its sample by an additional 159 projects; however we do not know which projects these were.

When the database was created in early 2008, previous QRF activity from September 2007 to April 2008 was analyzed, and populated into relevant database fields to reflect prior micro-purchases. At that time, the documentation was not uploaded to the database. This in no way infers that the documentation doesn't exist. We certainly understand SIGIR's concern over documentation not being in the database.

As discussed with the SIGIR audit team in December 2010 and throughout the drafting process of the prior audit report, the vast majority of missing documents were in actuality for projects completed prior to the establishment of the database. This was certainly the case for the initial 25 database records from Anbar province that SIGIR noted as "$421,000 was either lost or stolen" in its first audit report draft. <u>The documentation for all 25 Anbar projects was retrieved from the finance office files and turned over to SIGIR on January 12, 2011.</u>

Even before the completion of the SIGIR audit report in April 2011, the Department of State began to respond to SIGIR's concerns. As the finance office officials researched document requests from SIGIR and pulled the vouchers from its files, they verified that the vouchers pertained to the specific QRF projects and uploaded them to the database.

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NOTE: All payments made under the QRF program are official payments of the United States Government and are subject to certification by a United States Government Certifying Officer prior to payment or reimbursement to an authorized advance. Documentation for certified payments is kept on file in accordance to the Department of State / Federal government records retention policy for payment records.

Working with our database contractor, the Department of State also created a report function to identify all database records without documentation uploaded to ensure completeness of the database and to address SIGIR's concerns. With the information in this report, we began a long process to pull the finance office files from the storage containers on the Embassy compound to search for the processed vouchers. During the spring and fall of 2011 we researched and found all but 125. Further research was limited by rapidly declining staff, as the Office of Provincial Affairs officially closed on August 25, 2011. An additional 104 files were located and uploaded into the database in February 2012. The remaining files, it is believed, may have been lost in the move from the Palace to the New Embassy Compound. Because of the way QRF payments were processed, we are confident that these 21 projects were properly supported at the time of payment.

During this process, we worked with the Financial Management Office and Knowledge Management to obtain the missing vouchers. In order to pull the correct vouchers, we established a method to enable us to match the voucher numbers to the micro-purchase numbers in the QRF Database. As we reviewed the vouchers to match them to the correct micro-purchases, we noted that they appeared to be complete and certified. All payment requests require proper supporting documentation to enable the United States Government Certifying Officer in Baghdad to have certified the payments/reimbursements at the time they were processed independently of the PRT who implemented the project.

We concluded that the documents were in the proper format that was required under the program in 2007-2008. We noted no indications that would have led us to believe the certified vouchers represented fraudulent transactions. SF44 forms represent the purchase order, invoice, receiving report and/or public voucher in one document as designed and approved for use by the Department of State Office of the Procurement Executive (OPE). OPE has confirmed that the SF44 was the minimum requirement in 2007-2008. Our analysis also concluded that many of the micro-purchases included additional documentation, such as separately prepared vendor invoices.

We share SIGIR's desire that the database be as complete as possible and that the documentation support the completed projects. We have completed our assessment as outlined above to ensure the database is reflective of the program taken as a whole and provides as complete a picture as possible.

We conclude that the required documentation is now contained in the database and that relevant control procedures that existed at the time were followed. Given this, we are confident that the QRF Database adequately documents the QRF Program projects and that SIGIR's first recommendation from the April 2011 report has been satisfied.

Andrew Snow, Director
US Department of State
Bureau of Near East Affairs
Office of Iraq Economic and Assistance

Appendix C—DoS's Management Comments to SIGIR's Draft Report

United States Department of State

Washington, D.C. 20520

April 26, 2012

Stuart W. Bowen Jr.
Inspector General
Special Inspector General for Iraq Reconstruction
400 Army Navy Drive
Arlington, VA 22202

Dear Mr. Bowen:

The Bureau of Near Eastern Affairs (NEA) submits the following response to the letter on the Interim Review of State Department's Progress in Implementing SIGIR Recommendations Addressing Quick Response Fund Management Controls (SIGIR 12-016).
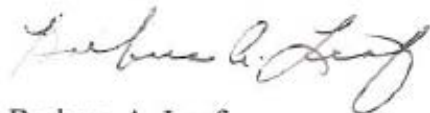
In its letter (SIGIR 12-016), SIGIR states that the QRF Program's reliance on the SF-44 document in lieu of invoices was inappropriate. On January 14, 2011 the Director of Federal Assistance in the Office of the Procurement Executive (OPE) e-mailed SIGIR the following statement: *"The SF-44 served as the purchase order, invoice, receiving report and/or public voucher..."* In response to a draft of SIGIR's letter, OPE confirmed its previous statement and further clarified to SIGIR that standard operating procedures for the use of the SF-44, as described in the QRF Guidelines, does meet the Simplified Acquisition Regulations and was cleared by A/OPE in 2007.

In Table 3 of its April 2011 report on QRF, SIGIR based its calculation of the percentage of "missing" documents not only on documents that were required, but also on documents that NEA/Iraq and Embassy Baghdad indicated were only requested (but not required.) Additionally, some project related documents which were not required or requested as part of the program in 2007-2008 were also counted towards the calculation. We informed SIGIR that in 2007-2008 only the SF-44 was required for micro-purchases, and that other documents were not required until later in the program. If the April 2011 report had considered only the documents that were required, the total percentage of missing documents for 2007-2008 in Table 3 of the April 2011 report would have shown a rate of 9% of documents missing, not 56% as SIGIR calculated.

We share SIGIR's concern that all program documentation be as complete as possible; however, we base our standard of complete on the requirements that were in place at the time of project implementation. As the situation in Iraq became safer, our ability to require additional documentation increased as noted by SIGIR's April 2011 audit.

I hope this information is useful. Please do not hesitate to contact me if you have additional questions.

Sincerely,

Barbara A. Leaf
Deputy Assistant Secretary for Iraq
Bureau of Near Eastern Affairs

Appendix D—Acronyms

Acronym	Description
DoS	Department of State
NEA	DoS Bureau of Near Eastern Affairs
PRT	Provincial Reconstruction Teams
QRF	Quick Response Fund
SIGIR	Special Inspector General for Iraq Reconstruction
USAID	United States Agency for International Development

Appendix E—Audit Team Members

This report was prepared and the audit conducted under the direction of James Shafer, Assistant Inspector General for Audits, Office of the Special Inspector General for Iraq Reconstruction.

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

Adam Hatton

Tinh Nguyen

William Whitehead

Appendix F—SIGIR Mission and Contact Information

SIGIR's Mission	Regarding the U.S. reconstruction plans, programs, and operations in Iraq, the Special Inspector General for Iraq Reconstruction provides independent and objective: • oversight and review through comprehensive audits, inspections, and investigations • advice and recommendations on policies to promote economy, efficiency, and effectiveness • deterrence of malfeasance through the prevention and detection of fraud, waste, and abuse • information and analysis to the Secretary of State, the Secretary of Defense, the Congress, and the American people through Quarterly Reports
Obtaining Copies of SIGIR Reports and Testimonies	To obtain copies of SIGIR documents at no cost, go to SIGIR's Web site (www.sigir.mil).
To Report Fraud, Waste, and Abuse in Iraq Relief and Reconstruction Programs	Help prevent fraud, waste, and abuse by reporting suspicious or illegal activities to the SIGIR Hotline: • Web: www.sigir.mil/submit_fraud.html • Phone: 703-602-4063 • Toll Free: 866-301-2003
Congressional Affairs	Hillel Weinberg Assistant Inspector General for Congressional Affairs Mail: Office of the Special Inspector General for Iraq Reconstruction 2530 Crystal Drive Arlington, VA 22202-3940 Phone: 703-428-1059 Email: hillel.weinberg.civ@mail.mil
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