IMPROPER OBLIGATIONS USING THE IRAQ RELIEF AND RECONSTRUCTION FUND (IRRF 2)

SIGIR-06-040
JANUARY 30, 2007
MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER),
U.S. DEPARTMENT OF DEFENSE
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U.S. ARMY CORPS OF ENGINEERS

SUBJECT: Improper Obligations Using the Iraq Relief and Reconstruction Fund (IRRF 2) (SIGIR-06-040)

We are providing this audit report for your information and use. We performed the audit in accordance with our statutory duties contained in Public Law 108-106, as amended, which requires that we provide for the independent and objective conduct of audits, as well as leadership and coordination of, and recommendations on, policies designed to promote economy, efficiency, and effectiveness in the administration of programs and operations and to prevent and detect waste, fraud, and abuse. This report discusses the circumstances related to questionable funds and subsequent actions taken or planned regarding the use of these funds.

This report does not contain recommendations; therefore, no written response to this report is required. A draft of this report was provided to the Chief Financial Officer, U.S. Army Corps of Engineers, and the Iraq Reconstruction Management Office. We received informal comments from the Iraq Reconstruction Management Office, which were addressed in the final report, as appropriate.

We appreciate the courtesies extended to the staff. For additional information on this report, please contact Mr. Joseph T. McDermott, Assistant Inspector General for Audit, (703-604-0982 / joseph.mcdermott@sigir.mil), or Mr. Steven Sternlieb (steven.sternlieb@sigir.mil / 703-428-0240). For the report distribution, see Appendix C.

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Inspector General

cc: See Distribution
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Improper Obligations Using the
Iraq Relief and Reconstruction Fund (IRRF 2)

SIGIR-06-040
January 30, 2007

Executive Summary

Introduction

Congress appropriated $18.4 billion for the rebuilding of Iraq in Public Law 108-106, the Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan. This money is known as the Iraq Relief and Reconstruction Fund 2 (IRRF 2).\(^1\) On September 22, 2006, we issued an interim audit report on improper obligations using IRRF 2.\(^2\) As a result of our interim findings, and as agreed to with senior U.S. Army Corps of Engineers officials, we further report on the circumstances related to these questionable funds and subsequent actions taken or planned by GRD regarding the use of these funds. This is our final report.

In our September 2006 interim report, we concluded that $362 million in obligations did not constitute proper obligations. These funds were recorded as obligations by the U.S. Army Corps of Engineers (USACE) Gulf Region Division (GRD)\(^3\) in USACE’s financial records under a general contingency account used to enter data into a data field for vendors when no specific vendor entity existed. Because we concluded that the obligation of funds from IRRF 2 must be made for \textit{bona fide} purposes prior to their expiration on September 30, 2006, we issued an interim audit report so timely action could be taken by USACE on the use of these funds. In providing official oral comments on our interim findings, the USACE Chief Financial Officer (CFO) agreed with our conclusion that the $362 million in IRRF 2 funds that were obligated to non-existent vendors were not proper obligations. He advised us that USACE was seeking a solution to meet its needs to fund future contingency and close-out costs in a manner that constitutes proper obligations. In further discussions with USACE’s GRD staff in Iraq we were told that GRD had been previously advised that it could obligate IRRF 2 funds for contingencies to this general account.

\(^1\) P.L. 108-11 established the $2.48 billion Iraq Relief and Reconstruction Fund 1 (IRRF 1). The scope of this report does not include IRRF 1 funds.


\(^3\) In December 2005, shortly before the events covered by this audit (January-November 2006), the Project and Contracting Office (PCO) and the USACE Gulf Region Division (GRD) merged into one organization to form GRD-PCO. On October 1, 2006, the financial management functions of PCO were absorbed into GRD. Because of this organizational change, we refer to GRD as the organization currently responsible for the financial management of IRRF.
Objectives

The overall objective of this audit was to describe the events surrounding GRD’s decision to obligate the funds in question in Fiscal Year 2006 for future contingency requirements beyond Fiscal Year 2006, why GRD believed that it was proper to do so, and what has became of those funds. Specifically, the objectives of the audit were to determine:

- What legal guidance was provided to GRD on whether it could obligate IRRF 2 funds for contingencies?
- What became of the funds associated with the obligations that we questioned as improper?
- What procedures are in place regarding IRRF 2 expired funds?

Results

On January 28, 2006, GRD developed an internal plan, including financial guidance. The purpose of the plan included ensuring that there were sufficient obligated funds in the expired IRRF 2 appropriation to close out design-build contracts during Fiscal Year 2007 and beyond.\(^4\) The plan underwent legal review at multiple levels within the Department of Defense (DoD). Sometime in the February-March 2006 timeframe, the then senior official in the DoD Office of General Counsel (Fiscal) orally indicated to the Director, Management and Control, in the Army Budget Office,\(^5\) that the proposed plan to obligate IRRF 2 funds for contingencies was permissible, but a written opinion was not provided. In June 2006, after a change in personnel, the new senior official in the DoD Office of General Counsel (Fiscal) reached the opposite conclusion—that the proposed plan was not proper. As of October 2006, this remains the DoD legal position, albeit not written.

A series of actions were taken between September 29, 2006, and October 4, 2006, to ensure that the funds in question remained available consistent with appropriations law. These funds were returned to the Department of the Army, moved to the custody of USACE, allowed to expire, and then returned to GRD for its use. On September 29 and 30, 2006, a total of $385.2 million in IRRF 2 funds were returned to the Department of the Army:

- $378.8 million in deobligated funds that were returned by GRD on September 29-30, 2006, which included the $362 million questioned in our interim report
- $6.4 million still held for the defunct Office of Reconstruction and Humanitarian Assistance, the original agency established for Iraq reconstruction

On September 29 and 30, 2006, the Department of the Army reissued to USACE the $385.2 million in returned IRRF 2 funds. These funds expired at midnight on September 30, 2006.

\(^4\) A design-build contract places the design and building phases of a project under the same contract.
\(^5\) This official is now the USACE CFO.
On October 3 and 4, 2006, USACE in turn issued $385.2 million in expired IRRF 2 funds to its subordinate command, GRD.

IRMO has developed procedures for the use of expired funds, *Updated Procedures for Iraq Relief and Reconstruction Fund (IRRF) Expired Funds*, November 28, 2006. They require each IRRF-implementing organization to notify or receive approval from IRMO on the use of the expired funds, depending on the amount involved. However, we found that GRD has been directed by the USACE CFO, rather than IRMO, to use the $385.2 million of expired IRRF 2 funds to take actions to meet its contingency expectations. This amount represents almost all (99%) of the $389.2 million total expired funds that were deobligated and returned to the Department of the Army at the end of Fiscal Year 2006 for all agencies.\(^6\)

The use of expired funds has been the subject of considerable discussion between IRMO and GRD and is but one aspect of a broader problem—how to manage future costs to complete work across the range of IRRF projects. USACE has conducted a detailed review of the cost to complete its pre-September 30, 2006 IRRF-funded contracts and has quantified its need for the expired funds. While GRD has quantified its requirements for the use of the expired funds, IRMO’s procedures call for its approval on a case-by-case basis to ensure the best use of limited funds. We believe that having IRMO’s approval is a good start, but it may be challenging from a strategic perspective.

**Recommendations**

As GRD has addressed our previous recommendation to safeguard the availability of the $362 million that had been improperly obligated, and because actions are underway to clarify the use of the expired IRRF 2 funds, we make no further recommendations.

**Management Comments and Audit Response**

This report contains no recommendations; therefore no written response was required. A draft of this report was provided to USACE and IRMO. USACE officials responded with no comments to add. IRMO officials provided technical comments, which were addressed in the final report. IRMO officials concurred and had no additional comments.

\(^6\) Of the $389.2 million in expired funds, GRD controlled $385.2 million, and other agencies controlled the balance of $4 million.
Introduction

Background

Congress appropriated $18.4 billion for the rebuilding of Iraq in Public Law 108-106, the Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan. This money is known as the Iraq Relief and Reconstruction Fund 2 (IRRF 2). These funds were to remain available until September 30, 2006, at which time the authority to initially obligate these funds expired.

On September 22, 2006, we issued an interim audit report on improper obligations using IRRF 2. Our review determined that $362 million recorded in the U.S. Army Corps of Engineer’s (USACE’s) financial records did not constitute proper obligations. As a result of our interim findings, and as agreed to with senior U.S. Army Corps of Engineers officials, we further report on the circumstances related to these questionable funds and subsequent actions taken or planned by the USACE Gulf Region Division (GRD) regarding the use of these funds. This is our final report.

Responsible Organizations

The Coalition Provisional Authority was initially responsible for managing the construction and contracting efforts in the reconstruction of Iraq through its Program Management Office. In June 2004, the Program Management Office was redesignated the Project and Contracting Office (PCO). In December 2005, shortly before the events covered by this audit, the PCO and the USACE GRD merged into one organization to form GRD-PCO. On October 1, 2006, the financial management functions of PCO were absorbed into GRD. Because of this organizational change, we refer to GRD as the organization currently responsible for the financial management of IRRF for the Department of Defense (DoD).

Project and Contracting Office (PCO)

National Security Presidential Directive 36, United States Government Operations in Iraq, May 11, 2004, established the PCO and directed the PCO to provide acquisition and project management support for activities in Iraq. On June 22, 2004, the Deputy Secretary of Defense established the PCO within the Department of the Army and directed the PCO to provide support to the Chief of the U.S. Mission in Iraq for all activities associated with financial, program, and project management for both construction and non-construction IRRF activities.

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7 P.L. 108-11 established the $2.48 billion Iraq Relief and Reconstruction Fund 1 (IRRF 1). The scope of this report does not include IRRF 1 funds.
8 Interim Audit Report on Improper Obligations Using the Iraq Relief and reconstruction Fund (IRRF 2), (SIGIR-06-037, September 22, 2006).
**U.S. Army Corps of Engineers Gulf Region Division (GRD)**

The GRD provides engineering services in the Iraq combat theater to Multi-National Force-Iraq, the Department of State, the U.S. Agency for International Development, and the Iraqi government with planning, design, and construction management support for military and civil infrastructure construction.

**Iraq Reconstruction Management Office (IRMO)**

National Security Presidential Directive 36\(^9\) also established IRMO, a temporary office within the Department of State and the U.S. Mission in Iraq, to facilitate the transition to a democratically elected, sovereign government of Iraq. IRMO executes its mission by assisting the U.S. Ambassador in setting reconstruction policy and provides expertise and operational assistance to Iraqi ministries in the reconstruction process. IRMO responsibilities relative to IRRF include strategic planning, prioritizing requirements, monitoring spending, and coordinating with the applicable military commander.

**Interim Audit Report Raised Concerns About Improper IRRF 2 Obligations**

In our September 2006 interim report we concluded that $362 million in IRRF 2 obligations recorded by GRD in USACE’s financial records under a general contingency account used to allow entering data into a data field for vendors when no specific vendor entity existed did not constitute proper obligations. Because we concluded that the obligation of funds from IRRF 2 must be made for *bona fide* purposes prior to their expiration on September 30, 2006, we issued an interim audit report so timely action could be taken by USACE on the use of these funds.

We reported that the establishment of these obligations was not consistent with a 1995 decision by the Comptroller General of the United States on appropriations availability, the U.S. Government Accountability Office’s (GAO) Appropriations Law Manual, and the DoD Financial Management Regulation requirements for the recording and reviewing of commitments and obligations. Appropriated amounts are limited for obligation to a definite period and are available only for payment of expenses properly incurred during that period. Thus, unless obligated consistent with GAO and DoD guidance on what constitutes proper obligations during their period of availability, any amounts reserved as a contingency would not be available to support obligations arising after expiration of their period of availability. Consequently, we concluded that the $362 million recorded in USACE’s financial records as obligations for contingency requirements with no actual vendor entity were not proper obligations of IRRF 2 funds. Further, if these funds were not obligated against discrete contracts (or other recordable transactions) consistent with GAO and DoD guidance on what constitutes proper obligations, the authority to obligate them would expire on September 30, 2006.

As a result, in our September 22, 2006, report, we recommended that the Commanding General, USACE, direct GRD to immediately review the obligations established for the transactions without an actual vendor name and, to the extent practicable, take steps to obligate these funds consistent with GAO and DoD guidance on what constitutes proper obligations by September 30, 2006; or alternately take steps to assure that the funds remain legally available. In providing official oral comments on our interim findings, USACE’s Chief Financial Officer (CFO) agreed with our conclusion that the $362 million in IRRF 2 funds obligated to non-existent vendors were not proper obligations. The CFO advised us that he was seeking a solution to meet USACE’s needs to fund future contingency and close-out costs in a manner that constitutes proper obligations. According to the CFO, he was recommending that GRD deobligate these funds immediately and return the funds to the Department of the Army. He also said that he planned to let these funds expire on September 30, 2006, and to maintain these expired funds for in-scope modifications in Fiscal Year 2007. In further discussions with senior GRD staff, we were told that GRD had been previously advised that it could obligate IRRF 2 funds for contingencies to a general account.

Objectives

The overall objective of this audit was to describe the events surrounding GRD’s decision to obligate the funds in question in Fiscal Year 2006 for future contingency requirements beyond Fiscal Year 2006, why GRD believed that it was proper to do so, and what has became of those funds. Specifically, the objectives of the audit were to determine:

- What legal guidance was provided to GRD on whether it could obligate IRRF 2 funds for contingencies?
- What became of the funds associated with the obligations that we questioned as improper?
- What procedures are in place regarding IRRF 2 expired funds?

For a discussion of the audit scope and methodology, and a summary of prior coverage, see Appendix A. For the acronyms, see Appendix B. For the report distribution, see Appendix C. For a list of the audit team members, see Appendix D.
Contingency Advice Provided to GRD Changed Over Time

On January 28, 2006, GRD developed an internal plan, including financial guidance. The purpose of this plan included ensuring that there were sufficient obligated funds in the expired appropriation to close out its design-build contracts during Fiscal Year 2007 and beyond. The plan underwent legal review at multiple levels within DoD. Between February 2006 and September 2006, the legal advice provided to GRD changed from unacceptable—to acceptable—and finally unacceptable. As of November 2006, the DoD legal position is that it is not permissible to obligate IRRF 2 funds for contingencies.

GRD’s Plan for Assuring Adequate Funding

On January 28, 2006, GRD developed an internal plan entitled *IRRF II Contingency Management Plan and Financial Guidance for FY 06*. The plan’s stated purpose was to:

- Establish a common definition-set for successfully closing out the IRRF 2 appropriation at the end of Fiscal Year 2006.
- Ensure that there were sufficient obligated funds in the expired appropriation to close out its design-build contracts during Fiscal Year 2007 and beyond.

The plan’s rationale stated that the Army Budget Office had informally agreed to obligate funds for project contingency based on reasonable estimates such as the cost-to-complete report. When actual obligation amounts became known, the estimated amount for obligation would be reversed and replaced with the actual amount. GRD personnel were to ensure that this reversal took place. Proposed legislative language to be submitted by the Department of the Army with the Fiscal Year 2006 request for supplemental appropriations was to further validate this process.

The plan emphasized the importance of good financial management, stating the following:

- While it was vital that sufficient funds be available to complete projects that are underway and planned, it is equally important not to hold excess funds.
- It is imperative to identify available funds early and execute in a prudent and expeditious manner.
- A contingency management plan is pivotal in balancing risk and opportunity while continuing to execute the IRRF 2 program.

The plan contained definitions and “way-ahead” financial treatment. It defined available funds as those funds that are not committed or obligated and have not been identified for

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10 The cost-to-complete report contains estimates of the cost required to complete each project funded with IRRF 2.
a specified purpose. These funds were deemed available for new projects, modifications of ongoing projects, increases for design-build close-out, and/or for design-build contingency as needed. The plan further stated that the use of these funds was at the discretion of the Chief of Mission who delegated responsibly to senior IRMO staff and the Director of IRMO, in consultation with the sectors.

For design-build close-out, funds were defined as those set aside for closing out design-build cost-reimbursement contracts plus any other validated close-out costs. The proposed approach was for design-build close-out funds identified on the cost-to-complete report to be committed on a single purchase request and commitment (a funding document used for contracting) and then obligated on a miscellaneous obligation document per project code. These were the actions that resulted in the obligations recorded as transactions without an actual vendor that were the subject of our interim report.

The Office of the Assistant Secretary of the Army for Financial Management and Comptroller developed proposed legislative language on January 5, 2006, or before the internal plan was completed, but it was subsequently decided to not send it forward. The language was as follows:

“Notwithstanding any other provision of law, whereas some of the Iraq construction projects will be completed in fiscal year 2007 with no new appropriated funds anticipated for the Iraq Relief and Reconstruction Act, under PL 108-106, these funds may be obligated at the sector level in FY06 for project close-out costs based on reasonable estimates, such as cost at completion analyses. For the purpose of this section, project close-out costs are in-scope changes to existing construction projects, and any other costs associated with closing out existing contracts, including claims, for the projects and construction contracts that were in place prior to fund expiration.”

According to USACE’s CFO, the legislative language was prepared and discussed within DoD in about the first week in January 2006. On November 18, 2006, the CFO told us that on January 6, 2006, the legislative proposal was discussed between himself, in his former capacity as the Director, Management and Control, in the Army Budget Office; senior Office of Management and Budget officials; and senior DoD financial management officials. According to the CFO, the Office of Management and Budget, on about January 7, 2006, recommended the contingency/close-out provision not be submitted as there was no precedence for such action and it was asking Congress to prescribe obligation rules in the supplemental.

GRD’s plan was based on USACE’s long-standing practice of funding contingencies for projects involving military construction appropriations. This practice normally involves committing 5% of the estimated project’s construction cost for contingency requirements which are then obligated when actual in-scope contract changes are required. Military

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11 At the time of the January 6, 2006, discussion, the individual who is currently the USACE CFO was the Director, Management and Control, in the Army Budget Office. He became the USACE CFO on April 1, 2006.
Construction projects are basically all fixed price contracts involving lower risk of contingency while the GRD contracts in Iraq were cost reimbursable contracts with higher risk for contingency costs. GRD’s legal counsel noted that the situation GRD faced in Iraq was similar to the situation USACE faces in the final year of projects funded with military construction appropriations.\textsuperscript{12} GRD’s legal counsel further noted that contingencies are not obligated in the last year the military construction appropriation is available; rather, USACE requests additional funds from Congress. However, in the case of IRRF 2 there were no successor appropriations and we found no evidence where there were any requests for additional funds to meet this purpose.

**Legal Guidance Changed Over Time**

Between February 2006 and September 2006, legal counsel at multiple levels within DoD addressed GRD’s proposed plan for obligating funds for contingencies. Specifically, the following organizations within DoD were involved:

- GRD Division Counsel
- USACE Office of the Chief Counsel
- Department of the Army, Office of General Counsel
- DoD Office of General Counsel

There were a series of discussions regarding GRD’s internal plan involving legal counsel in GRD, USACE headquarters, and the Department of the Army Office of General Counsel. In the course of those discussions the predominant view was that the proposed plan to obligate IRRF2 funds for contingencies was not permissible. Specifically:

- On February 11, 2006, GRD Division Counsel raised concerns with USACE’s Office of the Chief Counsel about GRD’s proposed plan to obligate IRRF 2 funds for contingencies. The Division Counsel expressed the view that the proposal was GRD’s way to capture the contingencies of the cost reimbursable contracts today with expiring IRRF 2 Funds and expressed concern as funds are not supposed to be obligated for contingencies. These concerns were also communicated to both the PCO Comptroller and Finance and Accounting Officer as well as to the GRD Comptroller.

- On February 13, 2006, in responding to GRD’s Division Counsel, USACE Office of the Chief Counsel advised that if GRD’s plan is an attempt to obligate money for future out-of-scope modifications then it lacks any basis of authority. USACE Office of the Chief Counsel further stated that an out-of-scope modification must be funded with current year funds and he realized that in the case of IRRF there will be no current year funds.\textsuperscript{13} However, he noted that the lack of future funds did not relieve the fiscal constraints on the use of expired funds.

\textsuperscript{12} Funds appropriated for military construction are available for a 5-year period.

\textsuperscript{13} The USACE Chief Counsel did not specify a date, but the implication is that he was referring to funds beyond Fiscal Year 2006.
On February 24, 2006, Department of the Army Office of General Counsel advised USACE’s Office of the Chief Counsel that it shared its concern and had brought the matter to the attention of DoD’s Office of General Counsel (Fiscal).

Sometime in the February-March 2006 timeframe, the then senior official in the DoD Office of General Counsel (Fiscal) indicated to the then senior official in the Army Budget Office, that the proposed plan to obligate IRRF 2 funds for contingencies was permissible. This conclusion was provided orally, but no written opinion was provided. On November 16, 2006, we discussed this oral opinion with the USACE CFO who agreed with our observation that, with the exception of the senior official in the DoD Office of General Counsel (Fiscal), the predominant legal counsel view at the time was that the proposed plan was not permissible. However, the CFO noted that because the opinion that the proposed plan was permissible was provided at the DoD senior official level, that became the guiding position for making obligations to the general contingency account.

In June 2006, there was a change in personnel in the DoD Office of General Counsel (Fiscal) and the new senior official reached the opposite conclusion—that the proposed plan was not proper. This information was provided orally to the senior fiscal attorney in the Department of the Army Office of General Counsel. On September 6, 2006, USACE’s CFO requested a legal opinion from the Army Deputy General Counsel (Ethics and Fiscal) on USACE’s plan to reserve funds appropriated for IRRF for in-scope modifications and close-out costs by obligating contingency funds. During an October 19, 2006, meeting we had with the Department of the Army Deputy General Counsel (Ethics and Fiscal), he told us that he did not support GRD’s proposed plan that was submitted for a legal opinion in September 2006. According to the Army Deputy General Counsel (Ethics and Fiscal), he had not provided an opinion to USACE, and he had advised the USACE CFO that the Department of the Army General Counsel would not issue a written opinion supporting using IRRF for future contingencies.

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14 The officials involved in these discussions, and with whom we spoke, could not recall specific dates.
Status of GRD’s Expired IRRF 2 Funds

When appropriated funds expire they remain available for in-scope obligation adjustments (contract modifications within the scope of existing contracts) for a period of five years at which time they then become cancelled funds and are not available for any purpose relating to the original contract. It is common for contracts to be modified to reflect emerging needs within the original contract. Expired IRRF 2 funds are governed by the same appropriation law and regulations as other expired appropriated funds.

GRD committed to deobligate the funds we questioned in response to our interim report. A teleconference was held on September 29, 2006, between the Commanding General, GRD, the USACE CFO, and the Special Inspector General for Iraq Reconstruction. During this meeting, the Commanding General said that GRD would deobligate the $362 million in questioned IRRF obligations. The USACE CFO added that the $362 million in IRRF 2 funds would be held at headquarters Department of the Army in an account for USACE and allowed to expire on September 30, 2006. The funds would then remain available for five years for in-scope adjustments to existing IRRF 2 obligations before cancelling.

To put this in context, the USACE CFO told us that he believes that the IRRF appropriation was not compatible with the life cycle of major reconstruction projects because IRRF 2 was limited to a 3-year availability period, whereas appropriations normally used for major construction projects provide for a continuous funding stream that can be used to fund in-scope modifications. Since IRRF 2 was only available for obligation in Fiscal Years 2004 through 2006, and with many of the major construction projects starting in Fiscal Years 2005 and 2006, the IRRF 2 obligation period did not allow for normal in-scope modifications and close-out actions likely to occur in years beyond Fiscal Year 2006. However, as discussed earlier, GRD Division Counsel noted in February 2006 that the situation GRD faced in Iraq was similar to the situation USACE faces in the final year of projects funded with military construction appropriations. Rather than obligating funds for contingencies in the last year the military construction appropriation is available, USACE requests additional funds from Congress.

Between September 29, 2006, and October 4, 2006, a series of actions were taken by USACE to ensure that the funds we questioned, as well as an additional $22 million in IRRF 2 funds that expired on September 30, 2006, remained available consistent with appropriations law. These actions resulted in having the funds returned to the Army, allowed to expire, and then reissued to GRD as shown in Figure 1.
Figure 1: Timeline for Actions Involving GRD’s Expired IRRF 2 Funds

6. GRD
Committed $337.7 million of the expired funds as of Nov. 7, 2006

5. USACE
Returned $385.2 million to GRD on Oct. 3-4, 2006

4. USACE
$385.2 million expired at midnight on Sept. 30, 2006

3. Dept. of the Army
Issued $385.2 million to USACE on Sept. 29-30, 2006

2. GRD
Returned $378.8 million, and ORHA* returned $6.4 million, for a total of $385.2 million returned to the Dept. of the Army on Sept. 29-30, 2006

1. GRD
De-obligated $378.8 million of IRRF 2 on Sept. 29-30, 2006

Finish

Start

Source: SIGIR analysis of Army funding documents, as of October 4, 2006.

*Note: ORHA is the Office of Reconstruction and Humanitarian Assistance.
IRMO Has Developed Procedures for Use of IRRF 2 Expired Funds

IRMO has developed procedures for the use of expired funds, *Updated Procedures for Iraq Relief and Reconstruction Fund (IRRF) Expired Funds*, November 28, 2006. They require each IRRF-implementing organization to notify or receive approval from IRMO on the use of the expired funds, depending on the amount involved. However, we found that GRD has been directed by the USACE CFO, rather than IRMO, to use the $385.2 million of expired IRRF 2 funds to take actions to meet its contingency expectations. This amount represents almost all (99%) of the $389.2 million total expired funds that were deobligated and returned to the Department of the Army at the end of Fiscal Year 2006 for all agencies.

**IRMO Procedures for Expired Funds**

On May 11, 2004, National Security Presidential Directive 36 established IRMO with overall responsibility for the IRRF 2 program, although the Office of Management and Budget apportions funds directly to the agencies executing the IRRF 2 program. IRMO has developed procedures for the use of expired funds.

We have reviewed IRMO’s procedures for expired IRRF 2 funds. These procedures require that the use of expired IRRF 2 funds be limited to in-scope changes, requests for equitable adjustment, claims, and any unrecorded obligations. Requests for equitable adjustment, claims, and any unrecorded obligations are an immediate liability to the U.S. government and require only notification to IRMO. For in-scope changes, IRMO’s procedures state that even if a contracting officer determines that the legal authority exists to use expired funds for an in-scope change, such modifications must have IRMO approval and that such coordination is to ensure that the proposed in-scope modification is a higher policy priority than other potential competing funding requirements. IRMO concurrence and approval is required for modifications or changes exceeding $500,000. Modifications or changes less than $500,000 shall require notification only. Required documentation to IRMO for the use of expired IRRF 2 funds includes the change and current percentage of activity completion, to justify how the change will enhance the achievement of the objectives; whether the increase exceeds the previous month’s cost-to-complete estimate; and budget to include all direct and contingency costs.

In establishing IRRF 2 in Public Law 108-106 (117 STAT 1225), Congress allocated funds by sector, including for oil infrastructure, the electric sector, water, and sanitation. Congress also allowed the President to reallocate up to 10% of the original allocations. The appropriated funds were to be apportioned only to the Coalition Provisional Authority; the Departments of State, Defense, Health and Human Services, Treasury; and the U.S. Agency for International Development. The Office of Management and Budget apportioned the IRRF 2 funds to specific implementing agencies, principally the Departments of Defense and State, and the U.S. Agency for International Development. IRMO does not have ownership of the funds.
Interagency Discussions are Ongoing

Within the Department of the Army, expired funds are normally retained at the headquarters level. The major Army commands request and are issued funds on a case-by-case basis for in-scope adjustments as funds are required. However, in the case of the expired IRRF 2 funds, GRD has been given custody of the $385.2 million under the Army’s control. While GRD cannot use these funds without notification to or prior approval from IRMO depending on the amount requested, IRMO’s procedures implicitly assign these funds to GRD and will address their need for funds on an obligation-by-obligation basis. IRMO’s procedures seek to ensure that the proposed in-scope modification is a higher policy priority than other potential competing funding requirements. These procedures are designed to allow for a determination to be made on whether GRD’s financial needs reflect the best use of IRRF 2 funds in relation to requirements across all sectors and U.S. government agencies that are engaged in Iraq reconstruction.

Normally, expired funds are not committed and are only obligated at the time that they are actually required for in-scope adjustments for contracts. The USACE CFO said that he has directed GRD to establish commitments using the IRRF 2 expired funds to cover the contingency requirements of all on-going IRRF construction contracts that had previously been obligated in Fiscal Year 2006 and that were then deobligated at the end of September 2006. This indicates that USACE plans to reserve and use all expired IRRF 2 funds for GRD projects.

In discussing our analysis with IRMO’s Chief Financial Officer on December 20, 2006, we were told that the use of expired funds has been the subject of considerable discussion between IRMO and GRD. The IRMO CFO also commented that the use of expired funds is but one aspect of a broader problem—how to manage future costs to complete work across the range of IRRF projects. When discussing our analysis with the USACE CFO on December 21, 2006, he told us that USACE has conducted a detailed review of the cost to complete its pre-September 30, 2006 IRRF-funded contracts and has quantified its need for the expired funds. He also said that he did not believe IRMO should be involved in reviewing individual actions, but rather its focus should be one of strategic direction as funds are not apportioned to USACE through IRMO. During an earlier discussion with the USACE CFO (on December 15, 2006), about our question on the status of actions that he previously told us he was taking, he responded that he was continuing to vet the procedures on the expired IRRF appropriation with IRMO. The USACE CFO further observed that while he would agree that the Department of State is responsible for the management of the reconstruction effort, he believed that agencies receiving the IRRF funds are responsible for managing them.

On September 7, 2006, the CFO told us that he had initiated discussions with the Office of Management and Budget to determine the validity of the method he was using for reserving and recording IRRF 2 funds and planned to initiate discussions with the Department of State, which is responsible for managing IRRF.
While GRD has quantified its requirements for the use of the expired funds, IRMO’s procedures call for its approval on a case-by-case basis. We believe that having IRMO’s approval is a good start, but it may be challenging from a strategic perspective. In a January 16, 2007, discussion on how to ascertain if GRD’s proposed changes are the highest priority, IRMO officials told us that they cannot examine all requirements in advance as they are dependent on the contracting officers coming forward with proposed in-scope modifications. They also told us that the cost-to-complete reports provide a rough estimate on the need for expired funds, but not a hard figure. Further, the IRMO officials stated that GRD has most of the IRRF construction funds and other agencies such as the U.S. Agency for International Development and the Department of State—in their judgment—are likely to have limited need for expired funds.
Conclusion and Recommendations

Conclusion

At the time GRD took action to obligate funds for contingencies, it only had one of several legal opinions indicating that it was permissible. The legal advice provided to GRD and its parent command, USACE, changed from unacceptable—to acceptable—and finally unacceptable. The predominant legal counsel view at the time was that GRD’s proposed plan to obligate funds using unspecified vendors was not permissible. However, in February-March 2006, the period during which GRD implemented its plan to obligate IRRF 2 funds for contingencies, the then senior official in the DoD Office of General Counsel (Fiscal) orally indicated that this was permissible. Subsequently there was a change in personnel and the new senior official in the DoD Office of General Counsel (Fiscal) reached the opposite conclusion—that the proposed plan was not proper. This continued to be DoD’s position as of October 2006. Notwithstanding GRD and USACE requests for a formal opinion, none was ever issued.

The funds we identified in our interim report as improper obligations, along with other available IRRF 2 funds, were deobligated and then allowed to expire on September 30, 2006. As expired funds, they remain available for 5 years for in-scope contract modifications. After allowing these funds to expire, the Department of the Army and USACE returned them to GRD for its use. Reconstruction funds are made available at the discretion of senior IRMO staff and Chief of Mission. IRMO has procedures regarding the use of available IRRF 2 expired funds that require IRMO approval or notification depending on the amount.

The use of expired funds has been the subject of considerable discussion between IRMO and GRD, and is but one aspect of a broader problem—how to manage future costs to complete work across the range of IRRF projects. USACE has conducted a detailed review of the cost to complete its pre-September 30, 2006, IRRF-funded contracts and has quantified its need for the expired funds. While GRD has quantified its requirements for the use of the expired funds, IRMO’s procedures call for its approval on a case-by-case basis to ensure the best use of limited funds. We believe that having IRMO’s approval is a good start, but it may be challenging from a strategic perspective.

Recommendations

As GRD has addressed our previous recommendation to safeguard the availability of the $362 million that had been improperly obligated, and because actions are underway to clarify the use of the expired IRRF 2 funds, we make no further recommendations.

Management Comments and Audit Response

This report contains no recommendations; therefore no written response was required. A draft of this report was provided to USACE and IRMO. USACE officials responded with no comments to add. IRMO officials provided technical comments, which were addressed in the final report. IRMO officials concurred and had no additional comments.
Appendix A – Scope and Methodology

On September 22, 2006, we issued an interim audit report on what we detected to be $362 million in improper Iraq Relief and Reconstruction Fund (IRRF) obligations recorded by the U.S. Army Corp of Engineers (USACE) Gulf Region Division (GRD) during our ongoing audit of unmatched disbursements. As a result of our interim findings, we further reviewed the circumstances related to these questionable funds and subsequent actions taken or planned by GRD regarding the use of these funds (Project 6036).

The overall objective of this audit was to describe the events surrounding GRD’s decision to obligate the funds in question in Fiscal Year 2006 for future contingency requirements beyond Fiscal Year 2006, why GRD believed that it was proper to do so, and what has become of those funds. Specifically, the objectives of the audit were to determine:

- What legal guidance was provided to GRD on whether it could obligate IRRF 2 funds for contingencies?
- What became of the funds associated with the obligations that we questioned as improper?
- What procedures are in place regarding IRRF 2 expired funds?

To determine what legal guidance was provided GRD on whether it could obligate IRRF 2 funds for contingencies, we held discussions with officials from each of the following General Counsel offices within the Department of Defense:

- GRD Division Counsel
- USACE Office of the Chief Counsel
- Department of the Army, Office of General Counsel
- DoD Office of General Counsel (Fiscal)

We reviewed relevant documents, including GRD’s January 28, 2006, plan entitled *IRRF II Contingency Management Plan and Financial Guidance for FY 06* and correspondence discussing the plan. We also held a conference call with USACE’s Chief Financial Officer (CFO) and GRD’s Commanding General to discuss the basis for their actions.

In order to determine what became of the funds associated with the obligations we questioned as improper, we obtained the IRRF 2 Funding Authorization Documents from the Office of the Assistant Secretary of the Army (Financial Management and Comptroller) and from USACE that were issued at the end of Fiscal Year 2006 and at the beginning of Fiscal Year 2007. We reviewed those documents and developed spreadsheets to chronicle the actions taken in the Funding Authorization Documents. We

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also held discussions with the USACE CFO and other USACE financial management officials.

To determine the procedures that were in place for expired IRRF 2 funds, we contacted USACE and Iraq Reconstruction Management Office (IRMO) officials. We reviewed GRD documents describing IRMO’s procedures and IRMO’s November 28, 2006, memorandum prescribing procedures for expired IRRF funds. We also reviewed Public Law 108-106, the Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, to identify how Congress intended funds be allocated.

We performed this review from July 21, 2006, through December 21, 2006, in accordance with generally accepted government auditing standards.

**Use of Computer-Processed Data**

To perform this audit we used data that originated in the U.S. Army Corps of Engineers financial management system. We did not test the general or application controls of this system. However, to determine data validity, we compared the system data to source documents (contract delivery orders, shipment receiving documents, and contractor invoices). This assessment indicated the data was sufficiently reliable to fairly portray the obligations recorded without vendor names.

**Prior Coverage**

We reviewed applicable reports issued by SIGIR.

# Appendix B – Acronyms

<table>
<thead>
<tr>
<th>ACRONYM</th>
<th>DESCRIPTION</th>
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<tbody>
<tr>
<td>CFO</td>
<td>Chief Financial Officer</td>
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<tr>
<td>DoD</td>
<td>Department of Defense</td>
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<tr>
<td>GAO</td>
<td>Government Accountability Office</td>
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<tr>
<td>GRD</td>
<td>Gulf Region Division, U.S. Army Corps of Engineers</td>
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<tr>
<td>IRRF 2</td>
<td>Iraq Relief and Reconstruction Fund 2</td>
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<tr>
<td>IRMO</td>
<td>Iraq Reconstruction Management Office</td>
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<tr>
<td>PCO</td>
<td>Project and Contracting Office</td>
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<tr>
<td>SIGIR</td>
<td>Special Inspector General for Iraq Reconstruction</td>
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<tr>
<td>USACE</td>
<td>U.S. Army Corps of Engineers</td>
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Appendix C – 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
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

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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 Terrorism
  Subcommittee on Near Eastern and South Asian Affairs
Senate Committee on Homeland Security and Governmental Affairs
  Subcommittee on Federal Financial Management, Government Information and International Security
  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 Foreign Operations, Export Financing and Related Programs
  Subcommittee on Science, State, Justice and Commerce and Related Agencies
House Committee on Armed Services
House Committee on Government Reform
  Subcommittee on Management, Finance and Accountability
  Subcommittee on National Security, Emerging Threats and International Relations
House Committee on International Relations
Subcommittee on Middle East and Central Asia

*Recipient of the draft audit report.
Appendix D – Audit Team Members

This report was prepared and the review was conducted under the direction of Joseph T. McDermott, Assistant Inspector General for Audit, Office of the Special Inspector General for Iraq Reconstruction. The staff members who contributed to the report include:

Karen Bell
Shawn Kline
Kenneth Littlefield
Richard McVay
Steven Sternlieb
Jason Venner
**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

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