MEMORANDUM FOR U.S. AMBASSADOR TO IRAQ
DIRECTOR, DEFENSE SUPPORT OFFICE - IRAQ

SUBJECT: Oversight of Funds Provided to Iraqi Ministries through the National Budget Process (Report No. 05-004)

We are providing this report for your information and use. We performed the audit in accordance with our statutory duties contained in Public Law 108-106, which mandated that we conduct audits relating to the treatment, handling, and expenditure of funds by the Coalition Provisional Authority (and its successor entities) on Iraq reconstruction, and of the programs, operations, and contracts carried out in utilizing such funds.

We considered management comments provided in response to a draft of this report when preparing the final report. Additional comments to this report are not required.

We appreciate the courtesies extended to the staff. For additional information on this report, please contact Mr. Brian M. Flynn at (703) 343-9440 or Mr. Robert M. Murrell at (703) 428-0240. We will provide a formal briefing on the results of the audit, if desired. See Appendix H for the report distribution.

Stuart W. Bowen, Jr.
Inspector General
Executive Summary

Introduction. This audit report discusses the oversight of Development Fund for Iraq (DFI) funds provided to Interim Iraq Government (IIG) ministries through the national budget process. The Coalition Provisional Authority (CPA) was the authority responsible for the temporary governance of Iraq through June 28, 2004. Thereafter, the IIG was the authority responsible for the governance of Iraq. Therefore, this report does not address the CPA management or use of U.S. appropriated funds.

Objective. The original objective of the audit was to determine whether the CPA had implemented adequate procedures for recording, reviewing, and reporting disbursements. During the audit, we limited the scope to review procedures and controls to only DFI funds provided to the interim Iraqi government through the national budget process. Specifically, we determined whether the CPA established and implemented adequate managerial, financial, and contractual controls over DFI disbursements provided to interim Iraqi ministries through the national budget process.

Results. The CPA provided less than adequate controls for approximately $8.8 billion in DFI funds provided to Iraqi ministries through the national budget process. Specifically, the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner. Consequently, there was no assurance the funds were used for the purposes mandated by Resolution 1483.

- Managerial Controls. The CPA did not implement adequate managerial controls over DFI funds provided to Iraqi ministries through the national budget process. Specifically, authorities and responsibilities over DFI funds were not clearly assigned, and CPA regulations, orders, and memoranda did not contain clear guidance regarding the procedures and controls for disbursing funds for the national budget.

- Financial Controls. The CPA did not implement adequate financial controls to ensure DFI funds were properly used. Specifically, the CPA did not exercise adequate responsibility over DFI funds provided to Iraqi ministries through the national budget process. Additionally, although the CPA published approved national budgets and total disbursements to Iraqi ministries on the Internet, it was not transparent what the funds were actually used for. Lastly, the CPA did not maintain adequate documentation to support budget spending plans, budget disbursements, or cash allocations made by coalition forces.

- Contract Controls. The CPA did not adequately control DFI contracting actions. Specifically, the CPA contracting office did not review contracting procedures at
the Iraqi ministries. In addition, CPA senior advisors and staffs did not provide oversight of Iraqi ministry procurements or contracting operations and executed contracts through the national budget process that were not in compliance with CPA Memorandum Number 4 guidance.

Conclusion. While acknowledging the extraordinarily challenging threat environment that confronted the CPA throughout its existence and the number of actions taken by CPA to improve the IIG budgeting and financial management, we believe the CPA management of Iraq’s national budget process and oversight of Iraqi funds was burdened by severe inefficiencies and poor management. Although we did not include all aspects of the threat environment or all CPA actions to improve the IIG budgeting and financial management in our audit scope and, therefore, cannot verify the validity of statements made. The management comments to this report provide the detailed opinions of the CPA Administrator and the Defense Support Office – Iraq on those issues.

Finally, although formal recommendations were not made in this report, we believe that the results of this audit dictate that lessons learned studies should be performed addressing not only the planning for specific managerial, financial, and contractual controls in future situations of this nature but also the national planning aspects necessary to overall management of these type of endeavors should they occur in the future. We are aware that other organizations have similar concerns. For example, the Office of the Secretary of Defense has initiated lessons learned studies concerning financial and logistics issues. However, we believe that those specific studies need to be brought together so that efforts can be better coordinated and be used to assist in formulating national planning initiatives. As such, rather than recommend others to perform this work, the SIGIR will take on the task of consolidating lessons learned studies that are specific in nature and also continue a broader scope lessons learned initiative previously started by this organization.

Management Comments and Audit Response. The initial comments on a draft of this report were received on July 18, 2004, from the Director, Iraq Reconstruction Management Office. The Director and the Senior Advisor to the Ministry of Finance/Office of Management and Budget concurred with the report. Subsequently, the Defense Support Office - Iraq disagreed with the report by providing informal comments on July 20, 2004, and revised informal comments on August 12, 2004. The CPA Administrator provided comments on September 8, 2004, and the Director of the Defense Support Office – Iraq provided comments on October 7, 2004. Those comments are included in the Management Comments section of the report.

The CPA Administrator and the Director, Defense Support Office – Iraq disagreed with the audit finding and stated the report did not acknowledge the difficult operational context in which the CPA was operating and did not recognize the actions taken to improve weaknesses in the Iraqi budgeting and financial management. We revised our report to address the comments from the CPA Administrator regarding the situation the CPA found in Iraq when it assumed control. However, their comments did not cause us to change our conclusion that the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner or that there was no assurance the funds were used for the purposes mandated by Resolution 1483. See the Finding section of the report for a discussion of the management comments and the Management Comments section of the report for the complete text of the comments.
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Background

This audit report discusses the oversight of Development Fund for Iraq (DFI) funds provided to Interim Iraq Government (IIG) ministries through the national budget process. The Coalition Provisional Authority (CPA) was the authority responsible for the temporary governance of Iraq through June 28, 2004. Thereafter, the IIG was the authority responsible for the governance of Iraq. Therefore, this report does not address the CPA management or use of U.S. appropriated funds.

Coalition Provisional Authority

Appointment of the Presidential Envoy to Iraq. In a letter dated May 9, 2003, the President of the United States appointed Ambassador L. Paul Bremer III as the Presidential Envoy to Iraq to report through the Secretary of Defense. Ambassador Bremer was authorized to oversee, direct, and coordinate all United States Government (USG) programs and activities in Iraq (subject to the authority, direction, and control of the Secretary of Defense), except those under the command of the Commander, U.S. Central Command. Ambassador Bremer’s authority included the responsibility to oversee the use of USG appropriations in Iraq, as well as Iraqi state- or regime-owned property that was properly under U.S. possession, and made available for use in Iraq to assist the Iraqi people and support the recovery of Iraq. The appointment letter further provided that all USG elements in Iraq, other than those under the command of the Commander, U.S. Central Command, operated under Ambassador Bremer’s authority and were to keep him fully informed of their activities.

Coalition Provisional Authority Regulation Number 1. CPA Regulation Number 1, May 16, 2003, was issued by Ambassador Bremer “Pursuant to my authority as Administrator of the Coalition Provisional Authority, relevant United Nations Security Council resolutions, including Resolution 1483 (2003), and the laws and usages of war. . . .”

CPA Regulation Number 1 stated “The CPA shall exercise powers of government temporarily in order to provide for the effective administration of Iraq during the period of transitional administration. . . .” CPA Regulation Number 1 also stated:

The CPA is vested with all executive, legislative and judicial authority necessary to achieve its objectives, to be exercised under relevant UN Security Council resolutions, including Resolution 1483 (2003), and the laws and usages of war. This authority shall be exercised by the CPA Administrator.

The Development Fund for Iraq

The Development Fund for Iraq. United Nations (UN) Security Council Resolution 1483 (Resolution 1483), May 22, 2003, noted the establishment of the DFI and assigned responsibility for managing the fund to the CPA. Resolution 1483 noted that DFI funds should be disbursed at the direction of the CPA, in consultation with the Iraqi interim administration. It also required the DFI funds be used in a transparent manner to meet the humanitarian needs of the Iraqi people, for the economic reconstruction and repair of Iraq’s infrastructure, for the continued disarmament of Iraq, for the costs of Iraqi civilian administration, and for other purposes benefiting the people of Iraq. See Appendix B for excerpts from Resolution 1483 concerning the DFI.
International Advisory and Monitoring Board. Resolution 1483 established the International Advisory and Monitoring Board (IAMB) of the DFI to perform functions similar to those of an outside audit committee. The letter from the Secretary-General to the President of the Security Council, dated October 22, 2003, established and approved the terms of reference for the IAMB. The terms of reference stated that the scope of the external audits shall encompass, among other things,

(iv) disbursements of resources from the DFI, supporting the objective of ensuring that DFI funds are used for the purposes for which they were disbursed. For purposes of (iv), the External Auditor(s) will make (a) a determination as to whether the disbursements from the DFI are duly authorized and received by the designated recipient; and (b) an assessment as to whether the controls (including the requirement to ensure proper records) of the designated recipient are adequate to ensure that disbursements from the DFI are utilized as intended.

See Appendix C for excerpts from the IAMB terms of reference letter.

Administration of the Development Fund of Iraq

Coalition Provisional Authority Regulation Number 2. CPA Regulation Number 2, “Development Fund for Iraq,” June 10, 2003, was issued by Ambassador Bremer “Pursuant to my authority as Administrator of the Coalition Provisional Authority (CPA), relevant UN Security Council resolutions, including Resolution 1483 (2003), and the laws and usages of war. . . .”

According to CPA Regulation Number 2, the guidance was issued for the following purpose.

This Regulation applies to the administration, use, accounting and auditing of the Development Fund for Iraq (the “Fund”). The Regulation is intended and shall be applied to ensure that the Fund is managed in a transparent manner for and on behalf of the Iraqi people, consistent with Resolution 1483, and that all disbursements from the Fund are for purposes benefiting the people of Iraq.

See Appendix D for excerpts from CPA Regulation Number 2 concerning the DFI.

Development Fund for Iraq Internal Control Review. CPA Regulation Number 2 required the CPA to obtain the services of an independent certified public accounting firm to ensure the fund was administered and used in a transparent manner for the benefit of the people of Iraq. In October 2003, the CPA awarded a $1.4 million contract to NorthStar Consultants, Inc., to evaluate the design and effectiveness of the internal control system over the DFI. The contract required the contractor to issue a written report evaluating the CPA internal controls and providing the results of its reviews of the CPA administration, use, and operation of the DFI.

Coalition Provisional Authority Regulation Number 3. CPA Regulation Number 3, “Program Review Board,” June 18, 2003, was issued by Ambassador Bremer “Pursuant to my authority as Administrator of the Coalition Provisional Authority (CPA), and consistent with relevant UN Security Council resolutions, including Resolution 1483 (2003), and the laws and usages of war. . . .”

According to Resolution 1483, the IAMB members include representatives to the Secretary-General of the United Nations, the Managing Director of the IMF, the Director-General of the Arab Fund for Social and Economic Development, and the President of World Bank.
CPA Regulation Number 3 addressed the establishment of the Program Review Board.

There is hereby established as a part of the CPA an entity to be known as the Program Review Board (“Board”). The Board shall report directly to the Administrator of the CPA (“Administrator”). The Board shall carry out its responsibilities, as defined in this Regulation, in a manner consistent with the CPA’s obligation to ensure that funds available to the CPA for providing relief to, and the recovery of Iraq are managed in a transparent manner and consistent with applicable law, for and on behalf of the Iraqi people. In addition, the Board shall, when and to the extent appropriate, consult the Iraqi interim administration referred to in paragraph 9 of Resolution 1483 (2003) [See Appendix B for paragraph 9 from Resolution 1483 concerning the Iraqi interim administration], and shall seek every opportunity to further the CPA’s objective of gradually transferring to the Iraqi interim administration the responsibility of budgeting Iraq’s financial resources. This Regulation establishes the procedures applicable to the Board’s operations.

CPA Regulation Number 3 also addressed the general duties of the Program Review Board.

The Board shall be responsible for recommending expenditures of resources from the Development Fund for Iraq and other resources identified in subsection 6 (3) of this Regulation, in a manner that meets the interests of the people of Iraq, furthers CPA’s policy objectives, and comports fully with the CPA’s stewardship and financial management duties under applicable laws and regulations, including United Nations Security Council Resolution 1483 (2003). The Board shall not be responsible for overseeing the manner in which approved spending requirements are executed.

**Iraqi National Budget**

In May 2003, a primary objective of the CPA was to establish a functioning government that would provide basic services to the Iraqi people, such as the payment of salaries and ministry operating expenses. The CPA, in coordination with the IIG ministries, formulated and approved the Iraqi national budgets. Rather than adopting a new national budget system, the CPA used the existing Iraqi national budget system. The Iraqi budget system required each ministry and government agency to submit monthly spending plans that identified the amounts required for salaries, operating expenses, and capital expenditures throughout the country. The budget system also required each ministry to submit a monthly trial balance that detailed how the previous month’s allocation was spent before the release of the current month’s funds.

The 2003 Iraqi national budget, developed by CPA, provided the authority for the commitment and expenditure of approximately $6.1 billion. The 2004 Iraqi national budget, approved by CPA in October 2003, authorized expenditures of approximately $13.4 billion; and a revised budget, approved by CPA in March 2004, increased authorized expenditures to approximately $19.9 billion. From October 2003 through June 24, 2004, the CPA disbursed approximately $8.8 billion in DFI funds through the national budget process for salaries, operating and capital expenditures, and capital projects. See Appendixes E and F for the DFI disbursements and financial reports posted on the CPA website.

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2 Dollar figures in this report have been rounded.
3 Capital expenditures include purchases of capital items necessary for the operation of a ministry, such as vehicles. They do not include capital projects or investments.
Contracting Procedures for the Development Fund for Iraq


Objective

The original objective of the audit was to determine whether the CPA had implemented adequate procedures for recording, reviewing, and reporting disbursements. During the audit, we limited the scope to review procedures and controls to only DFI funds provided to the interim Iraqi government through the national budget process. Specifically, we determined whether the CPA established and implemented adequate managerial, financial, and contractual controls over DFI disbursements provided to interim Iraqi ministries through the national budget process. The scope and methodology used to perform this audit and the prior coverage are discussed in Appendix A. The acronyms used in this report are shown in Appendix G and the audit team members are shown in Appendix I.
Oversight of Funds Provided to Iraqi Ministries

The CPA provided less than adequate controls for approximately $8.8 billion in DFI funds provided to Iraqi ministries through the national budget process. Specifically, the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner. Consequently, there was no assurance the funds were used for the purposes mandated by Resolution 1483.

Managerial Controls

The CPA did not implement adequate managerial controls over DFI funds provided to Iraqi ministries through the national budget process. Specifically, authorities and responsibilities over DFI funds were not clearly assigned, and CPA regulations, orders, and memoranda did not contain clear guidance regarding the procedures and controls for disbursing funds for the national budget. Further, staffing shortages and personnel turnover resulted in inadequate oversight of budget execution by the Iraqi ministries.

Authorities and Responsibilities. Authorities and responsibilities over the Iraq national budget funds were not clearly delineated. The CPA Administrator signed a memorandum on July 4, 2003, delegating authority to the CPA Senior Advisor for the Iraqi Ministry of Finance to administer the affairs of the Ministry of Finance, including the management of the IIG finances and the preparation, execution, and financing of the Iraq national budget. The memorandum stated the delegation of authority may be revoked at any time by the CPA Administrator or upon appointment of an interim minister by the IIG. CPA officials stated the delegation of authority was revoked when the Interim Iraqi Minister to the Ministry of Finance was appointed. However, CPA personnel were unable to provide a memorandum delegating authority to the Interim Iraqi Minister to the Ministry of Finance.

Additionally, CPA senior advisors' responsibilities for oversight of DFI financial and contracting actions in the Iraqi ministries were not clear. During discussions with nine senior advisors and/or senior consultants, CPA personnel stated that responsibilities over DFI funds were not clearly communicated to them. Consequently, 7 of 9 CPA senior advisors and staffs provided inadequate oversight of their respective Iraqi ministries’ financial operations. Further, senior advisors and staffs were not provided orientation or training on financial or contract duties and responsibilities. One senior advisor requested guidance from the CPA Office of General Counsel. In response, through an email dated February 21, 2004, the CPA Office of General Counsel stated the following:

There are no written guidelines delineating the senior advisors’ role, responsibilities and authorities. The Administrator expects the interim Iraqi Ministers to assume responsibility for and exercise authority over all recurring, day-to-day functions of their Ministries. We’re increasingly empowering the interim Ministers, consistent with their capacities. The senior advisors serve as the primary liaison between the Administrator and the Ministers. They provide advice and assistance to the Ministers, but do not exercise decision making authority over routine ministry matters. The advisors are expected to keep the Administrator fully informed of activities within their Ministries, and ensure proper development, coordination, promulgation and implementation of any ministry policy initiatives that extend beyond routine ministry functions.
Coalition Provisional Authority Guidance. CPA regulations, orders, and memoranda did not contain clear guidance regarding responsibilities, procedures, and controls for disbursing DFI funds for the national budget. CPA Regulation Number 2 stated that procedures for disbursing funds from the DFI would be prescribed in the CPA Order (subsequently established by CPA Regulation Number 3) establishing the Program Review Board (PRB). However, neither the CPA Regulation Number 3 that established the PRB nor the CPA Memorandum Number 4 that implemented CPA Regulation Number 3 included procedures regarding DFI disbursements to Iraqi ministries, except to state the CPA Office of Management and Budget (OMB) would allocate the funds. Additionally, CPA Regulation Number 3 assigned responsibility to the PRB Program Review Committee to distribute procedures for submitting funding requests. However, we were not able to locate any procedures regarding requests for funds to be disbursed to the Iraqi ministries. Lastly, CPA Regulation Number 3 stated the PRB would not be responsible for overseeing the manner in which approved spending requirements were executed, and we were unable to locate any other CPA guidance that assigned responsibility for providing oversight of DFI disbursements to IIG ministries. Consequently, documentation was not available to support disbursements to Iraqi ministries or explain significant differences between budget disbursements, ministry spending plans, and cash allocations.

Staffing and Personnel Turnover. According to CPA officials, the CPA Ministry of Finance/OMB experienced critical personnel shortfalls throughout 2003 and 2004. For example, during Fall 2003, when new salary policies were being implemented and the 2004 Iraq national budget was being revised, there were only six staff members assigned to the OMB budget team and all were inexperienced in government budget procedures. In addition, key financial management positions (Chief Financial Officer, Comptroller, and Senior Advisor to Ministry of Finance/Director of OMB) turned over on an average of three times since June 2003, and the Chief Financial Officer position was vacant for over three months. Finally, 3 of 9 IIG ministries we visited did not have personnel assigned to financial and/or budget positions.

Financial Controls

The CPA did not implement adequate financial controls to ensure DFI funds were properly used. Specifically, the CPA did not exercise adequate responsibility over DFI funds provided to Iraqi ministries through the national budget process. Additionally, although the CPA published approved national budgets and total disbursements to Iraqi ministries on the Internet, it was not transparent what the funds were actually used for. Lastly, the CPA did not maintain adequate documentation to support budget spending plans, budget disbursements, or cash allocations made by coalition forces. External assessments and allegations of corruption in Iraq’s ministries under the Oil-for-Food program should have raised concerns about the Iraqi government's ability to manage DFI Funds.

Responsibilities Over Funds Provided to Iraq Ministries Through the Development Funds for Iraq. The CPA did not exercise adequate responsibility over DFI funds provided to Iraqi Ministries through the national budget process. Specifically, the CPA disbursed over $8.8 billion in DFI funds to the Iraqi ministries without assurance the monies were properly used or accounted for. Neither CPA Ministry of Finance/OMB nor CPA senior advisors reviewed the internal controls in the Iraqi ministries. Further, CPA personnel did not review and compare financial, budgetary, and operational performance to planned or expected results. According to CPA Ministry of Finance/OMB officials, reviewing budget execution was not their responsibility. Rather, CPA personnel stated they relied on the Iraqi Board of Supreme Audit and had taken steps, such as appointing the inspectors general (which was not completed until May 2004) and establishing the Commission on Public Integrity, to build internal control and accountability measures at IIG ministries. However, these institutions were not yet functioning
and should not have been relied upon to monitor the Iraqi ministries use of DFI funds in 2003 and 2004. Resolution 1483 required the CPA to disburse funds from the DFI in a transparent manner to meet the needs of the Iraqi people. By not adequately reviewing the use of and accounting for the DFI funds provided to the Iraqi ministries, the CPA did not meet the mandate of Resolution 1483 with respect to this issue.

**Controls at Iraqi Ministries.** CPA officials did not review budget execution at Iraqi ministries even though external assessments indicated budget and financial control systems required strengthening. In June 2003, the International Monetary Fund (IMF) provided preliminary observations to CPA officials that noted the most urgent issue in the financial area was not budget planning but budget execution. Further, an October 2003 IMF assessment indicated the Iraqi ministries implementation of the budget would require a strengthening of payment and accounting functions, procurement procedures, and internal and external audit functions. The assessment also noted the difficulties that the Iraqi ministries were facing due to lack of staff, the security environment, disruptions in communications, damage and looting of government buildings, and lack of infrastructure and fiscal policies from before the occupation. In addition, a management consultant for the United States Agency for International Development reviewed internal controls at one Iraqi ministry in April 2004 and concluded financial management and internal controls over the ministry’s approximate $435 million budget were either weak or non-existent and the financial process was open to fraud, kickbacks, and misappropriation of funds. In light of the problems noted in the Iraqi ministries, combined with the lack of the financial reports for DFI spending, CPA officials should have reviewed internal controls and assisted the Iraqi ministries in preparing financial, budgetary, and operational performance reports.

In response to our draft audit, the CPA Administrator stated that, given the hostile situation the CPA found in Iraq, it was unrealistic for the coalition to achieve a standard of budgetary transparency and execution in the midst of a war. He stated there was no functioning Iraqi government, essential services were primitive or nonexistent, there was no national telephone system, and most Iraqi ministries had no computers. He further stated that Iraqi government budget and personnel records were destroyed by looting and sabotage and during Saddam’s era, less than 8 percent of annual state expenditures were run through the Ministry of Finance. He further stated that the CPA could find no reliable records of these “off budget” expenditures. He also stated the CPA discovered that the Iraqi ministries had no unified civil service pay system or regular payroll systems, and these systems had been corrupted beyond repair by decades of cronyism and ad hoc measures. Lastly, the CPA Administrator stated the Iraqi economy was "dead in the water;" so the CPA's top priority was to get the economy going.

**Salary Payments.** CPA did not implement adequate controls to ensure DFI funds were properly used for salaries of Iraqi employees. Consequently, there was no assurance funds were not provided for ghost employees. For example, CPA officials authorized payments of DFI funds for approximately 74,000 Facilities Protective Services (FPS) guards’ salaries even though the FPS sites and number of guards were not validated. CPA staff identified at one ministry that, although 8,206 guards were on the payroll, only 602 guards could be validated. CPA staff at another ministry validated the payroll at one FPS site and found that although 1,471 guards were on the payroll, only 642 guards could be validated. However, when the CPA staff recommended

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4 As of June 15, 2004, the Iraqi Ministry of Finance had not developed financial reports for DFI funds spent in 2003, and told CPA officials that financial data for November and December was lost.
5 Funds for salary payments were provided through the national budget process to the responsible Iraqi Treasury offices or the Iraqi Ministry of Finance. Coalition forces that hired the security forces (Iraqi Border Police, Iraqi Civil Defense Corps, Iraqi Armed Forces, and Facilities Protective Services) were responsible for salary payments until responsibilities were transferred to the Iraqi ministries.
the Iraqi Ministry of Finance require certified payrolls prior to salary payments, CPA Ministry of Finance personnel stated the CPA would rather overpay salaries than risk not paying employees and inciting violence. Furthermore, CPA payroll guidance to Iraqi ministries and coalition forces responsible for salary payments required only spreadsheets with summary totals6 be provided to the Iraqi Treasury offices responsible for disbursing the funds. Additionally, the CPA Ministry of Finance did not require coalition forces to provide supporting documentation for salary payments made before transferring responsibilities for payroll management to the Iraqi ministries. For example, the CPA Ministry of Finance/OMB could not provide documentation to support approximately $17 million provided to coalition forces for FPS and Iraqi Civil Defense Corps salaries in February 2004.

**Transparency.** The CPA sought to comply with the Resolution 1483 mandate for transparency by publishing the Iraqi national budgets and the total amounts of disbursements made to the Iraqi ministries on the Internet. For example, as of June 28, 2004, when the DFI was turned over to the IIG, the only budget information reported on the Internet was the approximately $8.8 billion in disbursements for ministry budgets and the total amounts provided to each ministry (see Appendixes E and F). However, transparency requires more than just posting budgets and total disbursements on the Internet. The CPA should have provided detailed budgetary, financial, and operational results of the DFI disbursements. Furthermore, although the UN provided approximately $2.5 billion dollars to the DFI in Oil-for-Food funds in March and April 2004, the CPA did not update the Iraqi national budget for the monies.

**Budget Documentation.** Adequate documentation was not maintained to support budget disbursements. CPA Memorandum Number 4 stated that funds allocated through the national budget process would be made available to the IIG ministries in accordance with the national budget, and the CPA OMB would allocate the funds to the Iraqi Ministry of Finance for further distribution to the Iraqi ministries in a manner that would ensure transparency. A review of 10 disbursements made by the CPA Comptroller’s office between October 2003 and June 2004 disclosed:

- None of the 10 disbursements - ranging between approximately $120 and $900 million - included documentation such as budget spending plans to support the amounts provided to the Iraqi ministries.
- Six disbursements were made without CPA/OMB allocation memoranda.
- Two disbursements totaling approximately $616 million were not supported by disbursement vouchers.
- An improper approximately $120 million disbursement was made in May 2004 because of miscommunication between the CPA/OMB and CPA Comptroller’s office.

Between January and April 2004, CPA OMB personnel developed the spending plans for the Iraqi ministries along with the cash allocations to be made to the banks to meet the monthly budget requirements. However, CPA OMB personnel were unable to provide supporting documentation or explain significant differences between the spending plans, budget disbursements, and cash allocations. For example, approximately $1.5 billion in cash allocations were made to Iraqi banks between January and April 2004 for operating expenses, yet spending plans supported only approximately $498 million in operating expenses.

**Financial Contractor Performance.** In October 2003, the CPA awarded a $1.4 million contract to NorthStar Consultants, Inc. to evaluate the design and effectiveness of the internal control system over the DFI. The NorthStar Consultants, Inc., were not certified public accountants and

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6 The CPA Ministry of Finance guidance required only summary totals of funds received, funds paid, number of employees by pay grade, and the remaining balance of funds.
did not perform a review of internal controls as required by the contract. Consequently, internal controls over DFI disbursements to and from Iraqi ministries were not evaluated. This occurred because a Contracting Officers Representative was not assigned to monitor contractor performance. Further, the Comptroller verbally modified the contract and employed the contractor personnel to primarily perform accounting duties in the Comptroller’s office.

**Contract Controls**

The CPA did not adequately control DFI contracting actions. Specifically, the CPA contracting office reviewed contracting procedures at 2 of the 26 Iraqi ministries. In addition, CPA senior advisors and staffs did not provide oversight of Iraqi ministry procurements or contracting operations and executed contracts through the national budget process that were not in compliance with CPA Memorandum Number 4 guidance. This occurred because the CPA issued procurement and contracting policy but did not implement procedures to determine compliance with the policy or monitor contracting actions in the Iraqi ministries. Consequently, contracts were entered into without the benefit of adequate contract controls.

**Contracting Procedures.** CPA Memorandum Number 4 established procedures for executing contracts with DFI funds. CPA Memorandum Number 4 required contracting officers to compete contracts and determine whether the contract price was fair and reasonable. Iraqi ministries and governmental agencies were also required to comply with the guidance in CPA Memorandum Number 4. An Iraqi ministry could execute contracts in accordance with Iraqi laws and ministry contracting procedures, but only if the CPA had determined and certified that the contracting procedures of the ministry were adequate to ensure the transparent use and management of DFI funds. If the contracting procedures of a particular Iraqi ministry were not determined to be adequate, the ministry was required to execute contracts through the CPA contracting office. However, the CPA contracting office reviewed and approved the contracting procedures of only two Iraqi ministries, the Ministry of Finance and the Ministry of Electricity, and those approvals did not occur until April 11, 2004, and June 26, 2004, respectively.

**Oversight.** CPA senior advisors and staffs did not provide oversight of Iraqi ministry procurements or contracting operations. Specifically, 5 of 7 CPA senior advisors and staffs did not provide adequate oversight of Iraqi ministry contracting operations. Further, we requested that CPA ministry senior advisors obtain data for contracts awarded with DFI funds, and, as of June 30, 2004, only 3 of 26 CPA ministry senior advisors (Communications, Housing and Construction, and Interior) were able to provide contracting actions taken by the IIG ministries. One of the Iraqi ministries that provided data indicated over 250 contracts valued at approximately $430 million were executed without CPA ministry advisors visibility over the contracts.

**Unauthorized Contracting Actions.** CPA senior advisors and staffs executed contracts through the national budget process without warrants or authority, and the contracts were not in compliance with CPA Memorandum Number 4 guidance. For example, a CPA senior advisor signed four Iraqi ministry contracts without competition, adequate contract specifications, or beneficial delivery terms and conditions. One of these contracts required full payment for three armored cars prior to shipment from Europe. Another CPA ministry advisor executed over

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7 The contract assigned responsibility to monitor contractor performance to the CPA Chief Financial Officer. However, the Chief Financial Officer assigned as the Contracting Officers Representative left Iraq on November 15, 2003, and when the Chief Financial Officer position was filled in March 2004 the newly assigned Chief Financial Officer was not assigned any duties over DFI funds or made aware of the NorthStar Consultants, Inc., contract.
20 contracts without contract authority; and a review of 10 contract files disclosed that 7 contracts were not competed and all 10 had missing or incomplete contract documentation.

**National Assembly Building.** The Governance Directorate, working with the Al Rasheed Company through the Ministry of Housing and Construction, began renovation of the National Assembly building without complying with CPA Memorandum Number 4 guidance. Before hostilities began in March 2003, the Al Rasheed Company, an Iraqi state–owned-enterprise, began remodeling the National Assembly building. During the rioting and looting at the conclusion of the war, the building and nine others in the compound were severely damaged and looted. In October 2003, the Al Rasheed Company and the Iraq State Commission of Buildings drafted an agreement to refurbish the compound buildings for $1,019,676. Subsequently, the CPA Governance Directorate established a requirement to renovate the National Assembly Building and the other buildings in the surrounding compound, and the CPA Administrator approved a budget of $5 million for the renovation in February 2004 and an additional $8.2 million to complete the project in March 2004. During the course of the project, the CPA Governance Directorate project manager issued verbal direction to the contractor that incorrectly conveyed to Iraqi officials that he had authority to enter into sole source contracts, and he advised Iraqi officials that rules requiring public bidding of subcontracts did not apply to the National Assembly project. These conditions occurred because the CPA did not implement procedures to ensure compliance with CPA Memorandum Number 4.

**Conclusion**

While acknowledging the extraordinarily challenging threat environment that confronted the CPA throughout its existence and the number of actions taken by CPA to improve the IIG budgeting and financial management, we believe the CPA management of Iraq’s national budget process and oversight of Iraqi funds was burdened by severe inefficiencies and poor management. Although we did not include all aspects of the threat environment or all CPA actions to improve the IIG budgeting and financial management in our audit scope and, therefore, can not verify the validity of statements made. The management comments to this report provide the detailed opinions of the CPA Administrator and the Defense Support Office – Iraq on those issues.

Formal recommendations were not made in this report because responsibility for the DFI transferred from the CPA to the IIG on June 28, 2004. However, the actions listed below that were taken by the IAMB and the CPA may mitigate the internal control weaknesses noted in the report.

**Assessment of Internal Controls.** On April 5, 2004, the IAMB selected KPMG Audit and Risk Advisory Services, Bahrain to perform an audit of the DFI financial statements and disbursements from the DFI, and to provide an assessment of internal controls of the recipients of DFI funds to determine whether the funds were used in a transparent manner and for the purposes for which they were disbursed. On July 14 and October 12, 2004, KPMG provided reports to the IAMB covering audits of DFI operations through December 31, 2003, and June 28, 2004, respectively.

**Coalition Provisional Authority Order Number 87.** On May 16, 2004, the CPA Administrator approved CPA Order Number 87, “Public Contracts.” CPA Order Number 87 applies to all procurements of goods, services, and construction services by Iraqi ministries, federal agencies, and governmental units that can commit public funds. CPA Order Number 87 requires full, fair, and open competitive public bidding procedures, international standards of transparency, procurement process integrity and minimum ethical standards, rights to file protests and related appeals, and dispute resolution mechanisms. In addition, CPA Order
Number 87 establishes an Office of Government Public Contract Policy that is responsible for coordination of government public contract policy for all ministries and public entities.

Coalition Provisional Authority Order Number 95. On June 4, 2004, the CPA Administrator approved CPA Order Number 95, “Financial Management Law and Public Debt Law.” CPA Order Number 95 provides detailed guidance for the conduct of fiscal and budgetary policy in Iraq and includes reporting requirements aimed at increasing the accountability and transparency of the budgeting process. CPA Order Number 95 addresses the preparation, adoption, recording, management, execution, and reporting of the federal budget of Iraq and related issues including internal controls, accounting, and auditing.

Finally, although formal recommendations were not made in this report, we believe that the results of this audit dictate that lessons learned studies should be performed addressing not only the planning for specific managerial, financial, and contractual controls in future situations of this nature but also the national planning aspects necessary to overall management of these type of endeavors should they occur in the future. We are aware that other organizations have similar concerns. For example, the Office of the Secretary of Defense has initiated lessons learned studies concerning financial and logistics issues. However, we believe that those specific studies need to be brought together so that efforts can be better coordinated and be used to assist in formulating national planning initiatives. As such, rather than recommend others to perform this work, the SIGIR will take on the task of consolidating lessons learned studies that are specific in nature and also continue a broader scope lessons learned initiative previously started by this organization.

Management Comments and Audit Response

Coalition Provisional Authority Administrator. The management comments provided by the CPA Administrator and the audit response to those comments are discussed below. The complete text of the comments is in the Management Comments section of the report.

Management Comments. The CPA Administrator disagreed with our report and stated that it did not acknowledge the context in which the CPA was operating or recognize the actions taken to improve weaknesses in the Iraqi budgeting system. He further stated that the report contained misconceptions, inaccuracies, and numerous factual errors that were brought to our attention by the Defense Support Office - Iraq and did not meet Inspector General standards.

Audit Response. We disagree. One issue was brought to our attention by the Defense Support Office – Iraq concerning contracting procedures that were approved for the Ministry of Electricity on June 26, 2004. However, the CPA Head of Contracting Activity approved these procedures on June 26, 2004, after our fieldwork in contracting was complete and validated with contracting officials. We revised the final report to include that information. Otherwise, the CPA Administrator did not provide any documentation or evidence to substantiate any other misconceptions, inaccuracies, or factual errors. Further, as stated in the report, the audit was conducted in accordance with generally accepted government audit standards.

Management Comments. The CPA Administrator stated that our report ignored the security context of the CPA role in Iraq and suggested the CPA should have delayed paying Iraqi public servants until fully modern pay records were implemented. He further stated more than a million Iraqi families depended on the government for their salaries and not paying the civil servants would have been destabilizing, would have increased the security threat to Iraqis and Americans, and would have cost lives.
The CPA Administrator also stated military commanders were instructed to build up the FPS force quickly to relieve the military of tasks such as providing static security to government buildings. The CPA decided in November to give Iraqis responsibility for the FPS forces by shifting the forces' payroll from the military commanders to the Iraqi ministries. Many IIG ministries, already struggling to cope with the new budgetary demands, had difficulties making the transfer. The CPA was aware of the problem and accepted that the payroll system was still imperfect, as there was a war going on and it would have been dangerous for security to stop paying armed young men.

Audit Response. The CPA Administrator’s criticisms are inappropriate. The report does not suggest the CPA should have delayed paying Iraqi public servants; instead, it addresses the lack of controls and supporting documentation for salary payments made by coalition forces to Iraqi security forces personnel. Specifically, the report addresses the CPA policy for coalition forces to support monthly salary payments with only summary information of total funds received and paid, and total number of employees by pay grade rather than certified payroll listings. The report also addresses the lack of supporting documentation maintained by the CPA. Furthermore, the six months that passed between the date the CPA decided to transfer payroll responsibilities and actually transferred those responsibilities to the Iraqi ministries was sufficient time to validate the payroll listings.

Management Comments. The CPA Administrator stated that our report ignored the political context of the CPA role in Iraq. The USG policy, mandated by UN Security Council resolutions, was to transfer as much responsibility as possible as quickly as possible to the Iraqis, including responsibility for the Iraqi budget. Clear guidance was provided to CPA Senior Advisors that Iraqi ministers, not the Senior Advisors, would run the ministries, and that the Senior Advisors were to leave the operations of the ministries, including the budgets, to the Iraqis. He further stated the report suggested that instead of giving the Iraqi ministers responsibility for their budgets, the CPA should have placed hundreds of auditors into the IIG ministries and that would have been directly contrary to USG policy and to the mandate of the UN.

Audit Response. The report does not suggest that CPA should have placed hundreds of auditors into the ministries or that CPA Senior Advisors should have run the ministries. Further, the report does not ignore the political context of the CPA role in Iraq but rather discusses the actions the CPA did not take to fulfill the responsibilities mandated by Resolution 1483 and the causes of those inactions.

The CPA had a responsibility to determine whether the Iraqi ministries had basic financial controls in place prior to transferring full authority over to the ministries. This responsibility was mandated by the UN, acknowledged by USG officials, was documented in the CPA Strategic Plan and was documented in CPA guidance.

UN Security Council Resolution 1511 required the return of responsibilities and authorities to the Iraqis as soon as practicable, but also reaffirmed Resolution 1483. The UN Security Council Secretary-General noted in an October 2003 letter discussing IAMB responsibilities that the CPA was responsible for establishing financial reporting and internal control systems to ensure DFI funds were used for the purposes for which they were disbursed.

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8 The letter from the UN Secretary-General to the President of the Security Council, October 22, 2003, stated one of the responsibilities of the IAMB was to monitor the financial reporting and internal control systems established by the CPA over disbursements from the DFI, supporting the objective of ensuring that DFI funds were used for the purposes for which they were disbursed.
USG officials acknowledged these responsibilities. Specifically,

- Secretary of State Colin Powell stated during a September 2003 press conference\(^9\) that one can't just say, “You’re a government, fine, go. You have full authority.” He stated there needed to be a deliberate process that builds the institutions of government and capacity to govern prior to the handover of sovereignty.

- The CPA Senior Advisor to the Ministry of Finance/Director of OMB notified all senior advisors in February 2004 that the CPA needed to determine whether there were adequate controls in the Iraqi ministries to ensure DFI disbursements were received by the designated recipient and used as intended. The Senior Advisor also requested the senior advisors provide the results of any internal reviews performed by their offices to ensure that proper controls were in place at the Iraqi ministries.

- The CPA Administrator acknowledged the CPA fiduciary responsibilities in March 2004. Specifically, the CPA Administrator stated during the transfer of sovereignty\(^10\) to the Ministry of Health, which was the first Iraqi ministry to attain sovereignty, that the CPA gave full authority to the Iraqi ministries only after fundamental financial and budgetary controls were in place. However, the CPA did not review internal controls or the accounting and use of funds in the Ministry of Health prior to the transfer, and CPA officials stated they were unaware of the basis for the CPA Administrator's statement that controls were in place.

- The CPA Press Secretary noted during the June 21, 2004, press briefing\(^11\) that coalition officials still had operational authority in the 11 Iraqi ministries that had not yet attained sovereignty. Since the Ministry of Finance was one of those 11 ministries, CPA officials still had operational authority and responsibility to ensure DFI funds were accounted for and properly used.

The CPA Strategic Plan documented the CPA responsibilities. For example, two key objectives in the economy section of the Strategic Plan were to develop transparent budgeting and accounting arrangements and to increase the capacity of the Ministries of Finance and Planning to manage public resources. A key task under these objectives was to conduct reviews of Iraqi budget expenditure and control systems. However, this task was not accomplished by CPA.

CPA Regulation Number 2 also documented the CPA responsibilities and required the CPA to obtain the services of an independent certified public accountant firm to ensure the fund was administered and used in a transparent manner. The CPA contract award required the contractor ensure disbursements were used for the purposes intended. Although the contractor submitted milestone reports stating they would review internal processes for controlling and documenting disbursements in the Iraqi ministries, the contractor did not perform these reviews. CPA Memorandum Number 4 further stated, as part of the CPA responsibility to ensure that funds were used for their intended purpose, the CPA Comptroller and Head of Contracting Activity could review contracting actions of interim Iraqi ministries.

**Management Comments.** The CPA Administrator stated that our report ignored the administrative context of the CPA role in Iraq and presumed the coalition could achieve a standard of budgetary transparency and execution which even peaceful Western nations would

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have trouble meeting within a year, especially in the midst of a war. When the CPA was established, there was no functioning Iraqi government and essential services were primitive or nonexistent. The Iraqi government budget and personnel records, inadequate before the war, had been destroyed and CPA determined that less than 8 percent of the annual state expenditures were run through the Ministry of Finance. The vast majority of government expenditures were directly controlled “off budget,” and the CPA could find no reliable records of these expenditures. The CPA discovered that the Iraqi ministries had no unified civil service pay system or regular payroll system and the systems had been corrupted beyond repair by decades of cronyism and ad hoc fixes. The CPA’s top priority was to get the economy going, and the quickest way was to pay the country's 1.2 million civil servants who had not been paid for two months. CPA established a four-grade pay scale, started paying civil servants, and established a professional civil-service pay system that was put in place in August 2003.

Audit Response. We disagree. Instead, the report discusses the actions the CPA did not take to fulfill it's responsibilities in light of this context. The audit's presumption that the USG should have practiced sound financial management and internal control over Iraqi monies is both realistic and supported by extensive legislation, policies, and procedures.

We fully recognize that the CPA operated in a dangerous working environment under difficult conditions. However, the existing administrative conditions should have underscored the need for controls over the disbursements to the Iraqi ministries. The CPA should have established controls and provided oversight over the financial management of the DFI funds precisely because there was no functioning Iraqi government, no experience within the Ministry of Finance in managing the national budget, no budget or personnel records, and the payroll systems were corrupted by cronyism and ad hoc fixes. On an individual basis, any of these conditions should have sent strong signals to financial managers that weaknesses were widespread, posed unacceptable risks, and called for forceful action. Those weaknesses should have represented goals for corrective actions, not reasons for inaction.

Management Comments. The CPA Administrator stated that our report did not adequately credit the major reforms the CPA instituted to deal with the deficiencies found in the Iraqi budgeting system. The CPA established the PRB to provide an open transparent mechanism for determining how to spend DFI funds; ensured there was Iraqi representation on the PRB; and posted the minutes, budget, and DFI funds balances on the Internet. The CPA established an independent judiciary, an Office of Inspector General in each Iraqi Ministry, an Iraqi Commission on Public Integrity, and revitalized and strengthened the Iraqi Board of Supreme Audit to fight corruption. The CPA introduced a Financial Management Information System to begin modernizing the Iraqi government's procedures and encouraged the World Bank and IMF to set up training programs and establish a program to restructure the chart of accounts to improve Iraqi capabilities.

Audit Response. We did not evaluate or address CPA actions related to formulating the budget because the audit’s focus was to review controls over disbursements. Similarly, we did not address the Financial Management Information System because it was not intended to account for DFI expenditures during the time the CPA was the governing body in Iraq. The report did address the adequacy of the information posted on the Internet and CPA reliance on the Anti-Corruption institutions even though these institutions were not yet functioning. Moreover, the CPA Administrator is silent the fact that the budget process includes more than decision-making on public finance matters and projecting revenues and expenses. The budget process also includes the management of the revenues and expenditures. The scope of the audit focused on this phase of the budget process.
**Director, Defense Support Office – Iraq.** The management comments provided by the Director, Defense Support Office – Iraq and the audit response to those comments are discussed below. The complete text of the comments is in the Management Comments section of the report.

**Management Comments.** The Director strongly disagreed with the report and stated the findings were not a basis for concluding that the CPA did not provide adequate stewardship of $8.8 billion in DFI funds. He stated that the conclusions were sweeping and unqualified, did not accurately represent the CPA management of the DFI, and were not substantiated by the findings that related only to the CPA oversight of the execution of funds. He further stated the CPA disbursed DFI funds to the Iraqi ministries consistent with the published national budget, and the funds were allocated, disbursed, and used in a transparent manner for the benefit of the Iraqi people.

**Audit Response.** We disagree. The objective of this audit was to review controls and procedures over disbursements provided to Iraqi ministries through the national budget process, not to evaluate the CPA overall management of the DFI. We concluded that the CPA did not provide adequate control of the funds because CPA officials:

- Were unable to provide any documentation to support that disbursements were managed against budgeted amounts.
- Were unable to support that funds were used for the purposes mandated by Resolution 1483.
- Had no assurance that funds were accounted for properly.
- Did not review financial reporting and internal control systems over disbursements.
- Did not publish a budget for $2.5 billion in Oil-for-Food funds received in March and April 2004 even though the funds were allocated and disbursed.

The Director acknowledged that there was no USG involvement in the Iraqi ministries’ accounting and use of the funds. The preceding facts call into question the Director's assertion that funds were allocated, disbursed, and used in a transparent manner for the benefit of the Iraqi people.

**Management Comments.** The Director stated our report failed to account for the objectives of USG policy to transfer responsibilities to Iraqis as soon as possible, which was consistent with international law and UN Security Council Resolutions. The CPA took the position that expenditures by Iraqi ministries were to be managed by the Iraqis and overseen by Iraqi auditors, and the CPA realized that the only practicable approach was to assume a supervisory role. Additionally, the Director commented that the security situation in Iraq made recruiting efforts extremely difficult and limited the assistance the CPA was able to provide to the Iraqi ministries in their budget execution.

**Audit Response.** We disagree. The report discusses areas where the CPA did not take actions to fulfill its responsibilities in determining whether the Iraqi ministries had established basic financial controls prior to transferring full authority to the Iraqi ministries. As previously stated in our audit response, the responsibilities were mandated by the UN and acknowledged by USG officials and were documented in the CPA Strategic Plan and in CPA guidance.

The CPA had a responsibility to determine whether the Iraqi ministries had basic financial controls in place prior to transferring full authority over to the Iraqi ministries. This responsibility was acknowledged by the CPA Administrator during the March 2004 transfer of sovereignty to the Ministry of Health, when the CPA Administrator stated that the coalition gave full authority to the Iraqi ministries only after fundamental financial and budgetary controls were in place. The CPA Press Secretary reiterated this responsibility when he noted that Iraqi
government workers still reported to coalition officials, who had operational authority, in the Ministry of Finance, as of June 21, 2004. Additionally, the CPA Strategic Plan and other official CPA guidance also documented these responsibilities.

**Management Comments.** The Director stated our report does not recognize the context in which the CPA was operating, to include the difficult circumstances under which the CPA operated and managed the DFI, the wartime security conditions, the CPA critical need to reestablish Iraqi ministries that had never functioned and/or had ceased to function, the ministries’ lack of basic tools such as computers and telephones, and the constraints of a largely cash economy.

**Audit Response.** We disagree. The report discusses the difficulties the Iraqi ministries and the CPA were facing, as noted by the IMF. It was precisely those conditions which underscored the need for controls over the disbursements provided to the Iraqi ministries. The fact that the Iraqi ministries ceased to or had never functioned, lacked basic tools, and operated in a cash economy was precisely why the CPA should have provided oversight of the financial management of the funds. However, we have revised our report to better reflect the difficult situation within which CPA operated.

**Management Comments.** The Director commented the report did not recognize a number of actions CPA took to improve budgeting and financial management and promote transparency and good governance.

**Audit Response.** We evaluated the actions that were relevant to the audit objectives. Specifically, we evaluated the adequacy of, and compliance with, CPA Regulation Numbers 2 and 3, CPA Memorandum Number 4, and acknowledged the new procurement and financial management laws that were issued in May and June 2004, respectively. We also addressed the CPA reliance on Iraq's Board of Supreme Audit and Inspectors General and the adequacy of the DFI financial information published on the CPA web page.

We did not address the economic reforms that had no impact on the accounting for and use of DFI funds during the time the CPA was the governing body in Iraq. Similarly, we did not address the Financial Management Information System because it was not intended to manage DFI expenditures during the period 2003 to 2004.

**Management Comments.** The Director stated that our audit disregarded the fact that the CPA took a number of actions to ensure transparency (i.e., publishing PRB meeting minutes and the Iraqi national budget and including Iraqis in the PRB) and focused only on the unavailability of near real-time budget execution data. He further stated the audit failed to present an international standard for transparency against which the CPA was being evaluated and presumed the CPA could achieve a standard of budgetary transparency and execution that even Western nations would have trouble meeting within one year, especially in a combat environment.

**Audit Response.** We recognize that the CPA took such actions to improve transparency but we did not address these actions in the report because they were not relevant to the audit objective. The Director disregarded the fact that the government budget process includes more than decision-making on public finance matters and projecting revenues and expenditures. The budget is a fundamental management tool for monitoring performance and the budget process also includes the actual management of revenues and expenditures.
We evaluated the CPA performance based on the standards included in the IMF Manual on Fiscal Transparency and Revised Code of Good Practices on Fiscal Transparency.\textsuperscript{12} That document includes principles and practices that emphasize the importance of publishing comprehensive fiscal information and identifies the information that should be provided during the budget preparation, execution, and reporting processes. Since the CPA goals were to restructure the Iraqi budget and accounting systems to conform to IMF standards, and the CPA arranged IMF training and workshops for Iraqi Ministry employees, the IMF standards were appropriate. The IMF standards represent internationally accepted criteria upon which audit verification can be tested and evaluated.

Finally, we disagree with management’s contention that the CPA could not provide detailed budgetary, financial, and operational results of the DFI disbursements during the time it was the governing body in Iraq. DoD policy requires that, even in contingency operations, the government establish controls, procedures, and accounting systems to properly account for funds. As stewards of the Iraqis' money, the CPA should have provided oversight of the financial management and internal controls in the Iraqi ministries to ensure the DFI funds were properly managed.

\textbf{Management Comments.} The Director stated that our report makes broad, un-validated statements based upon limited reviews and unclear standards of performance, since only 9 of the 26 senior advisors’ offices were reviewed and the audit was conducted over a span of several weeks near the end of the CPA tenure, yet formed conclusions on the performance of CPA as a whole over the CPA entire tenure. Further, during the time the audit was conducted, all CPA senior advisors were focused on the critical requirement of transitioning governance responsibilities to the Iraqi ministries.

\textbf{Audit Response.} We disagree. As stated in the report, the audit was conducted in accordance with generally accepted government audit standards, which include the use of sampling techniques to gather evidence needed to provide a reasonable basis for audit conclusions. We evaluated evidence gathered in the Iraqi Ministry of Finance/OMB, the Comptroller’s office, and 9 of 26 (35 percent) Iraqi ministries to provide a reasonable basis for the conclusions provided in the report. Additionally, fieldwork was conducted over a span of four months, not several weeks, and included a review of procedures and controls in addition to interviews with CPA officials who were in Iraq during the complete span of the CPA tenure. Furthermore, as previously stated, although one of the CPA Administrator’s criterion for transitioning governance was reviewing financial and budgetary controls, discussions with CPA officials in the Ministry of Finance/OMB and seven ministries during this period disclosed personnel did not review financial and budgetary controls in the Iraqi ministries prior to the transfer of governance. If the financial and budgetary controls in the Iraqi ministries were not reviewed prior to the transfer of governance, then it was not done, and a more lengthy audit would not have reached a different conclusion.

\textbf{Management Comments.} The Director stated that our report cited a single instance of poor management of the FPS and generalized that all salary payments were flawed when the FPS represented 74,000 employees, approximately six-tenths of 1 percent of the approximately 1.2 million Iraqis on the national payroll. The overriding priority was for the FPS to be established as soon as possible to relieve the pressure on coalition forces for providing fixed-site security. The CPA and DoD recognized that although it was necessary to entrust Iraqi ministry officials with the responsibility for expending Iraqi funds for salary purposes, such actions could

result in potential duplicate or otherwise improper payments. Prompt payment was considered to be absolutely vital to the safety and well being of the FPS guards and the Iraqi people in general.

**Audit Response.** We disagree. In this instance, the Director’s interpretation of the disclosure of limited support for salary payment issues in our report is erroneous. The issues addressed in the report are the lack of internal controls and supporting documentation for salary payments made by coalition forces to Iraqi security forces personnel. We reviewed controls over salary payments not only for FPS, but also for Iraqi Police Service, Border Police, National Guard, and Armed Forces. Further, the FPS payroll comprised over 6 percent (approximately 74,000 FPS employees divided by approximately 1.2 million national payroll employees) of the Iraqis on the national payroll, not six-tenths of 1 percent as stated by the Director.

The report addresses the CPA policy for coalition forces to accept as support monthly salary payments of DFI funds with only summary information of total funds received, paid out, and the total number of employees by pay grade rather than using certified payroll listings. The report also addressed the lack of supporting documentation maintained by the CPA for the DFI salary payments made by coalition forces. Furthermore, we reviewed controls over FPS salary payments made by coalition forces prior to the responsibilities being transferred to the Iraqi ministries in March and April 2004. Since coalition forces hired and paid these forces, we believe the CPA should have, at a minimum, provided validated site and payroll listings to the Iraqi ministries prior to the transfer of responsibilities.

**Management Comments.** The Director commented that although additional staff might have been helpful, the report did not provide any indication of how many personnel would have been sufficient to provide the level of oversight called for in the report. Further, there was no evidence that any Ministry of Finance/OMB staffing request was denied by the CPA.

**Audit Response.** Our report attributes the issue of staffing shortages to CPA officials. Three Senior Advisors to the Ministry of Finance/Directors of OMB stated they elevated requests for additional staff not only to the CPA Administrator but also to very senior levels of USG officials at the Departments of Defense, State, and Treasury, as well as OMB and other USG officials.

The numbers of requested staff varied among the CPA officials. For example, in September 2003, a Senior Advisor requested a total of 12 personnel with 4 projected to perform budget execution duties at the Iraqi Ministry of Finance. In December 2003, the Senior Advisor requested a minimum of 7 personnel, to include a Chief of Budget Execution with experience in international budget execution, to conduct a 2004 mid-year review. The December 2003 request stated OMB in Iraq had only 12 of 55 positions filled and the bulk of the personnel assigned were inexperienced recent college graduates.

**Management Comments.** The Director stated that at least one other ministry, the Ministry of Electricity, besides the Ministry of Finance had been approved for contracting.

**Audit Response.** The Director is correct. We agree that the Ministry of Electricity was authorized to perform contracting. However, the CPA Head of Contracting Activity approved these procedures on June 26, 2004, after our fieldwork in contracting was complete and validated with contracting officials. Nevertheless, we have revised our report to note the CPA approved contracting procedures for the Ministry of Electricity.

**Management Comments.** The Director commented that the statement in the report that the CPA did not update the Iraqi national budget to reflect budget plans for the approximately $2.5 billion dollars provided by the UN was not correct. He stated the CPA produced an updated working copy of the budget that was shared with the Iraqi Ministry of Finance. When asked, IIG officials indicated a preference that the CPA not officially publish the amended budget that had
been prepared. Rather, they preferred to leave final decisions regarding an amended budget to the new sovereign government. Their wishes were honored.

**Audit Response.** We disagree. We believe the CPA’s decision not to officially publish the revised budget, regardless of the IIG officials’ preferences, violated the Resolution 1483 requirement to use DFI funds in a transparent manner. An “updated working copy” fails to meet the requirements for a published annual budget.
Appendix A. Scope and Methodology

We performed this audit from May through October 2004 in accordance with generally accepted Government auditing standards. We interviewed key personnel responsible for the management of the Coalition Provisional Authority (CPA). We interviewed the CPA Administrator, General Counsel, Chief Financial Officer, Comptroller, Head of Contracting Activity, CPA Ministry of Finance/Office of Management and Budget Director, and staffs. We also interviewed Senior Advisors and/or Senior Consultants and staffs assigned to nine Interim Iraqi Government Ministries (Communications, Defense, Education, Health, Housing and Construction, Interior, Labor and Social Affairs, Oil, and Transportation). We reviewed the following documents.

United Nations and International Monetary Fund documents:
- Letter from the UN Secretary-General to the President of the Security Council, establishing the IAMB and approving the IAMB terms of reference, October 22, 2003

CPA Regulations, Orders, Memoranda, and Public Notices:
- CPA Regulation Number 1, May 16, 2003
- CPA Regulation Number 3, “Program Review Board,” June 18, 2003
- CPA Regulation Number 11, “Amendments to Coalition Provisional Authority Regulations No. 2 (CPA/REG/10 June 2003/02) and No. 3 (CPA/REG/18 June 2003/03),” June 15, 2004
- CPA Order Number 87, “Public Contracts,” May 14, 2004

CPA budget, financial, and contracting guidance documents:
- Budget Execution – Financing the Iraqi Budget
- Budget Execution Instruction
- Budget Execution Procedures for July 2003
- Instructions for Preparing the Budget for Year 2004
- Iraq’s Budget Execution Process
- Release of Operating and Capital Funds for July-August 2003, August 1, 2003
- Distributions by Department, and Distribution by Chapter, September 2, 2003
- Ministry Allocations by Governorate
- Contracting Responsibilities for the Iraqi Budget
We reviewed all available electronic and hard copy documents for the period May 2003 through July 2004 that were maintained by the CPA Ministry of Finance/OMB to include: the results of all internal control reviews and IMF assessments; Program Review Board budget approvals, allocations and minutes; and, budget spending plan, cash allocations, and salary documents. We reviewed all Program Review Board minutes to determine the turnover of key financial management personnel. We compared spending plans, cash allocations, and budget disbursements for January through April 2004. We verified vouchers and authorization memoranda for 10 high-dollar budget disbursements to Iraqi Ministries from November 2003 through June 2004.

We examined KPMG, Bahrain audit reports related to the Development Fund for Iraq. We also obtained and examined all available results of work performed by the Iraqi Inspector Generals and the Board of Supreme Audit.

We interviewed NorthStar Consultants, Inc. personnel and reviewed all contract file documentation maintained by the CPA Comptroller and Contracting Activity for work under Contract FY5866-04-C-001, “The Development Fund of Iraq Accountant Consultant,” October 25, 2003, to determine whether contractor personnel performed in accordance with contract requirements.

We examined all CPA Strategic Plan objectives and tasks related to the audit objectives. We interviewed contractor personnel and reviewed Financial Management Information System implementation updates. We also requested all CPA senior advisors obtain contract data from the Iraqi Ministries, determined the oversight of contracting actions by 7 ministry advisors, and judgmentally selected 15 contracts for detailed review.

Use of Computer-Processed Data. We did not rely on computer-processed data to perform this audit.

Prior Coverage. The Government Accountability Office (GAO) and the Special Inspector General for Iraq Reconstruction (formerly the Office of the Inspector General, Coalition Provisional Authority (IG CPA)) collectively issued six reports related to the Development Fund for Iraq. However, the objectives and scopes of those audits were not the same as discussed in this report. Reports issued by the Special Inspector General for Iraq Reconstruction can be accessed over the Internet at http://www.cpa-ig.org. Also, the International Advisory and Monitoring Board contracted with KPMG in Bahrain for audits concerning Development Funds for Iraq Export sales, Oil Proceeds, and Disbursements. The reports are listed below.


IG CPA Report No. 04-001, “Coalition Provisional Authority Coordination of Donated Funds,” June 25, 2004

IG CPA Report No. 04-007, “Oil for Food Cash Controls for the Office of Project Coordination in Erbil, Iraq,” July 26, 2004

IG CPA Report No. 04-008, “Coalition Provisional Authority Control Over Seized and Vested Assets,” July 30, 2004

IG CPA Report No. 04-009, “Coalition Provisional Authority Comptroller Cash Management Controls Over the Development Fund for Iraq,” July 28, 2004


KPMG Report, “Development Funds for Iraq - Matters Noted Involving Internal Controls and Other Operations during the Audit of the Fund for the Period to 31 December 2003,” June 29, 2004


United Nations Security Council Resolution 1483, May 22, 2003, established the Development Fund for Iraq and assigned responsibility for managing the fund to the Coalition Provisional Authority. United Nations Security Council Resolution 1483 provisions were organized under specific statements and paragraphs within the resolution and provided guidance for the management of the Development Fund for Iraq. Key statements include:

Noting the letter of 8 May 2003 from the Permanent Representatives of the United States of America and the United Kingdom of Great Britain and Northern Ireland to the President of the Security Council (S/2003/538) and recognizing the specific authorities, responsibilities, and obligations under applicable international law of these states as occupying powers under unified command (the “Authority” [the Coalition Provisional Authority],

4. Calls upon the Authority, consistent with the Charter of the United Nations and other relevant international law, to promote the welfare of the Iraqi people through the effective administration of the territory, including in particular working towards the restoration of conditions of security and stability and the creation of conditions in which the Iraqi people can freely determine their own political future;

9. Supports the formation, by the people of Iraq with the help of the Authority and working with the Special Representative, of an Iraqi interim administration as a transitional administration run by Iraqis, until an internationally recognized, representative government is established by the people of Iraq and assumes the responsibilities if the Authority;

12. Notes the establishment of a Development Fund for Iraq to be held by the Central Bank of Iraq and to be audited by independent public accountants approved by the International Advisory and Monitoring Board of the Development Fund for Iraq and looks forward to the early meeting of that International Advisory and Monitoring Board, whose members shall include duly qualified representatives of the Secretary-General, of the Managing Director of the International Monetary Fund, of the Director-General of the Arab Fund for Social and Economic Development, and of the President of the World Bank;

13. Notes further that the funds in the Development Fund for Iraq shall be disbursed at the direction of the Authority, in consultation with the Iraqi interim administration, for the purposes set out in paragraph 14 below;

14. Underlines that the Development Fund for Iraq shall be used in a transparent manner to meet the humanitarian needs of the Iraqi people, for the economic reconstruction and repair of Iraq’s infrastructure, for the continued disarmament of Iraq, and for the costs of Iraqi civilian administration, and for other purposes benefiting the people of Iraq;
Appendix C. United Nations Security Council
International Advisory and Monitoring Board
Terms of Reference

The letter from the Secretary-General to the President of the Security Council, dated October 22, 2003, established and approved the terms of reference for the International Advisory and Monitoring Board (IAMB). Key statements include:

1. **Purpose:**

   The purpose of the International Advisory and Monitoring Board shall be to promote the objectives set forth in the United Nations Security Council Resolution 1483 (2003) of ensuring that Development Fund for Iraq is used in a transparent manner for the purposes set out in operative paragraph 14 of that Resolution …

3. **Powers and Responsibilities:**

   B. **Scope of external audits.** The scope of the external audits shall be as to enable the IAMB to achieve its purpose as set out in 1 above. The scope of the external audits shall encompass: …(iii) the DFI (including, but not limited to, all inflows, investments and other assets, disbursements, liabilities and contingencies of the DFI), supporting the objective of ensuring that the DFI is used in a transparent manner in accordance with applicable control procedures; and (iv) disbursements of resources from the DFI, supporting the objective of ensuring that DFI funds are used for the purposes for which they were disbursed. For purposes of (iv), the External Auditor(s) will make (a) a determination as to whether the disbursements from the DFI are duly authorized and received by the designated recipient; and (b) an assessment as to whether the controls (including the requirement to ensure proper records) of the designated recipient are adequate to ensure that disbursements from the DFI are utilized as intended. This assessment shall be carried out as specified in the contract with the external auditor(s).

   D. **Internal Controls/Financial Reporting.** The IAMB shall monitor the financial reporting and internal control systems established by the CPA for the areas subject to external audit in 3.B above and advise, as appropriate, the CPA on the adequacy of such systems.
Appendix D. Coalition Provisional Authority
Regulation Number 2

On June 15, 2003, Ambassador Bremer issued Coalition Provisional Authority (CPA) Regulation Number 2, entitled the “Development Fund for Iraq,” which provided that:

This Regulation applies to the administration, use, accounting and auditing of the Development Fund for Iraq (the “Fund”). The Regulation is intended and shall be applied to ensure that the Fund is managed in a transparent manner for and on behalf of the Iraqi people, consistent with Resolution 1483, and that all disbursements from the Fund are for purposes benefiting the people of Iraq.

Key provisions of Section 2, “Responsibilities,” included:

1) Administrator of the CPA (Administrator). Oversees and controls the establishment, administration and use of the Fund for and on behalf of the Iraqi people, and directs disbursements from the Fund for those purposes he determines to be for the benefit of the people of Iraq.

3) CPA Program Review Board (PRB). Reviews all competing requirements for the relief and recovery of Iraq, assesses all available resources, and, in consultation with the Iraq interim administration, when established, develops for the approval of the Administrator spending plans, consistent with a comprehensive budgetary framework, that identify prioritized requirements for proposed disbursements from the Fund; considers in this process information provided by the CPA International Coordination Council, the International Advisory and Monitoring Board, and other entities, as appropriate.

Key provisions of Section 4, “Control of the Fund” included:

The Fund shall be controlled by the Administrator of the CPA, for and on behalf of the Iraqi people. The Central Bank of Iraq and the Federal Reserve Bank (and/or other financial institutions(s), if the Administrator so directs), shall accept instructions, as agreed, concerning the Fund, including instructions to pay sums out of the Fund, only from the Administrator or his authorized delegee(s).

Key provisions of Section 5, “Administration of the Fund” included:

4) Internal Accounting. The CPA shall obtain the services of an independent, certified public accounting firm to support the objective of ensuring that the Fund is administered and used in a transparent manner for the benefit of the people of Iraq, and is operated consistent with Resolution 1483. The accountants performing this function shall be separate from those public accountants (auditors) approved by the International Advisory and Monitoring Board.
Key provisions of Section 6, “Disbursements from the Fund” included:

1) Authority to Approve. Only the Administrator or his delegee may approve disbursements from the Fund.

2) Directions to Disburse. Sums shall be disbursed from the Fund, in accordance with this Regulation, only upon the express direction of the Administrator, or upon the express direction of individual(s) to whom the Administrator has delegated that authority.

3) Purposes. Sums may be disbursed from the Fund to meet the humanitarian needs of the Iraqi people and for the economic reconstruction and repair of Iraq’s infrastructure; for the continued disarmament of Iraq; for the costs of Iraq’s civilian administration; and for other purposes the Administrator determines to be for the benefit of the people of Iraq.

4) Proposals for Disbursements. Disbursements from the Fund generally shall be proposed through procedures prescribed in, or promulgated in implementation of the CPA Order establishing the PRB. These procedures shall ensure that proposed disbursements are set forth in a spending plan reflecting the cost, purpose and priority of the requirement, and that, prior to approval by the Administrator, all spending plans are developed in consultation with the Iraqi interim administration, once established.

Key provisions of Section 7, “Auditing” included:

The Fund and the export sales of petroleum, petroleum products, and natural gas from Iraq, shall be audited by independent public accountants nominated by the Administrator and approved by the IAMB. The expenses incurred in obtaining the services of the approved independent public accountants shall be charged against the Fund. The CPA shall cooperate fully with the IAMB and the approved independent public accountants in carrying out each party’s respective responsibilities. In particular, the CPA shall provide the IAMB and such accountants with access to the Fund’s financial records, with confidential materials protected in a manner agreed between the parties.
## Appendix E. Development Fund for Iraq
### Disbursements by Agency

| Agency                                | Disbursement Amount  
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Baghdad Central</td>
<td>$3,294,750.00</td>
</tr>
<tr>
<td>Central Bank of Iraq</td>
<td>$19,674,105.44</td>
</tr>
<tr>
<td>CJTF 7</td>
<td>$9,606,184.18</td>
</tr>
<tr>
<td>Coalition Military Assistance Training Team</td>
<td>$16,248,317.94</td>
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<tr>
<td>Commanders Emergency Response Program</td>
<td>$360,554,507.03</td>
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<tr>
<td>Communication Support Office</td>
<td>$1,659,897.06</td>
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<tr>
<td>Comptrollers Office</td>
<td>$3,565,200.00</td>
</tr>
<tr>
<td>CPA Front Office</td>
<td>$2,774,978.44</td>
</tr>
<tr>
<td>Governance</td>
<td>$10,000.00</td>
</tr>
<tr>
<td>Ministry of Agriculture</td>
<td>$31,250,385.80</td>
</tr>
<tr>
<td>Ministry of Communications</td>
<td>$2,080,000.00</td>
</tr>
<tr>
<td>Ministry of Culture</td>
<td>$20,000.00</td>
</tr>
<tr>
<td>Ministry of Defense</td>
<td>$562,711.50</td>
</tr>
<tr>
<td>Ministry of Education</td>
<td>$1,100,000.00</td>
</tr>
<tr>
<td>Ministry of Electricity</td>
<td>$639,205,316.51</td>
</tr>
<tr>
<td>Ministry of Finance</td>
<td>$7,711,940,159.57</td>
</tr>
<tr>
<td>Ministry of Health</td>
<td>$55,033,103.15</td>
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<tr>
<td>Ministry of Housing and Construction</td>
<td>$405,031.66</td>
</tr>
<tr>
<td>Ministry of Industry and Minerals</td>
<td>$18,950.00</td>
</tr>
<tr>
<td>Ministry of Interior</td>
<td>$47,852,851.64</td>
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<tr>
<td>Ministry of Justice</td>
<td>$1,000,219.50</td>
</tr>
<tr>
<td>Ministry of National Security &amp; Defense</td>
<td>$3,130,506.39</td>
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<tr>
<td>Ministry of Oil</td>
<td>$2,012,397,915.48</td>
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<tr>
<td>Ministry of Planning</td>
<td>$5,558,698.00</td>
</tr>
<tr>
<td>Ministry of Public Works</td>
<td>$26,116.00</td>
</tr>
<tr>
<td>Ministry of Trade</td>
<td>$444,076,620.36</td>
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<tr>
<td>Ministry of Transportation</td>
<td>$1,706,687.00</td>
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<tr>
<td>Office of Security Cooperation</td>
<td>$40,419,321.46</td>
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<tr>
<td>Private Sector Development</td>
<td>$13,665.00</td>
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<td>Program Management Office</td>
<td>$76,720,000.00</td>
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<tr>
<td>Rapid Regional Response Program</td>
<td>$244,216,497.75</td>
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<tr>
<td>Regional Projects - CPA South</td>
<td>$46,783,087.16</td>
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<tr>
<td>State Oil Marketing Organization</td>
<td>$76,620,172.65</td>
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<td>Strategic Communications</td>
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<tr>
<td>World Food Programme</td>
<td>$143,376,100.00</td>
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</table>

**Grand Total: $11,893,196,850.37**

Appendix F. Development Fund for Iraq
Financial Reporting Matrix

<table>
<thead>
<tr>
<th>Development Fund for Iraq (DFI) - Financial Reporting Matrix</th>
</tr>
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<tbody>
<tr>
<td>Reporting Date: June 26, 2004</td>
</tr>
<tr>
<td>As of Date: June 24, 2004</td>
</tr>
<tr>
<td>Inception Date: May 28, 2003</td>
</tr>
<tr>
<td><strong>Bank Accounts and Investments</strong></td>
</tr>
<tr>
<td>US Dollars</td>
</tr>
<tr>
<td>Central Bank of Iraq - Oil Proceeds Receipt Account, FRB, NY</td>
</tr>
<tr>
<td>616,499.19</td>
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<tr>
<td>DFI Account - Federal Reserve Bank, New York</td>
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<tr>
<td>151,544.75</td>
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<tr>
<td>DFI Account - Central Bank of Iraq, Baghdad</td>
</tr>
<tr>
<td>1,050,527,283.09</td>
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<tr>
<td>DFI Account - Treasury Bills at Purchase Price</td>
</tr>
<tr>
<td>4,768,665,359.51</td>
</tr>
<tr>
<td>DFI Account - Overnight Deposits, FRB, New York</td>
</tr>
<tr>
<td>1,673,300,000.00</td>
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<tr>
<td>DFI Account - Vested Assets, Federal Reserve Bank, New York</td>
</tr>
<tr>
<td>21,716.63</td>
</tr>
<tr>
<td>DFI Account - Temporary Cash Holdings</td>
</tr>
<tr>
<td>70,971,490.00</td>
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<tr>
<td><strong>Total - DFI Assets</strong></td>
</tr>
<tr>
<td>7,564,253,893.17</td>
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<tr>
<td><strong>Cash Inflow (Since Inception)</strong></td>
</tr>
<tr>
<td>Oil For Food</td>
</tr>
<tr>
<td>8,100,000,000.00</td>
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<tr>
<td>Proceeds from Oil Exports</td>
</tr>
<tr>
<td>11,111,692,362.73</td>
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<tr>
<td>UNSCR 1483 - Repatriated Funds</td>
</tr>
<tr>
<td>1,014,805,645.22</td>
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<tr>
<td>Interest Income - Treasury Bills</td>
</tr>
<tr>
<td>33,874,372.53</td>
</tr>
<tr>
<td>Interest Income - Overnight Deposits, Repurchase Agreements</td>
</tr>
<tr>
<td>7,636,464.80</td>
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<tr>
<td>Returned Letter of Credit Funding</td>
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<tr>
<td>3,686,295.39</td>
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<tr>
<td>Other Deposits</td>
</tr>
<tr>
<td>542,455.97</td>
</tr>
<tr>
<td>Donations</td>
</tr>
<tr>
<td>20,000.00</td>
</tr>
<tr>
<td>United Nations World Food Program</td>
</tr>
<tr>
<td>145,878,779.00</td>
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<tr>
<td>Vested Assets (Including Interest)</td>
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<tr>
<td>16,291,014.19</td>
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<tr>
<td>Transactional Deposits from Public Sector Entities</td>
</tr>
<tr>
<td>162,954,456.80</td>
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<tr>
<td><strong>Total Cash Inflow</strong></td>
</tr>
<tr>
<td>20,597,381,846.63</td>
</tr>
<tr>
<td><strong>Cash Outflow (Since Inception)</strong></td>
</tr>
<tr>
<td>Ministry Budgets</td>
</tr>
<tr>
<td>(8,825,926,528.27)</td>
</tr>
<tr>
<td>Payments for Projects.</td>
</tr>
<tr>
<td>(3,348,865,439.20)</td>
</tr>
<tr>
<td>Transactional Withdrawals - Public Sector Entities</td>
</tr>
<tr>
<td>(886,846,675.18)</td>
</tr>
<tr>
<td>Miscellaneous Transactions</td>
</tr>
<tr>
<td>(32,105,810.00)</td>
</tr>
<tr>
<td><strong>Total Cash Outflow</strong></td>
</tr>
<tr>
<td>(13,093,744,452.65)</td>
</tr>
<tr>
<td><strong>Net Cash Position</strong></td>
</tr>
<tr>
<td>7,503,637,393.98</td>
</tr>
<tr>
<td><strong>Outstanding Contractual Commitments</strong></td>
</tr>
<tr>
<td>Total PRB Approved Commitments (Since inception)</td>
</tr>
<tr>
<td>19,697,863,666.63</td>
</tr>
<tr>
<td>Commitments Returned / Cancelled</td>
</tr>
<tr>
<td>(3,185,642,810.08)</td>
</tr>
<tr>
<td>Commitments Paid</td>
</tr>
<tr>
<td>(11,892,642,550.37)</td>
</tr>
<tr>
<td><strong>Outstanding Commitments</strong></td>
</tr>
<tr>
<td>4,619,578,306.18</td>
</tr>
<tr>
<td><strong>DFI Assets On Hand Committed to Remaining 2004 Budget</strong></td>
</tr>
<tr>
<td>2,884,059,087.80</td>
</tr>
</tbody>
</table>
## Appendix G. Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPA</td>
<td>Coalition Provisional Authority</td>
</tr>
<tr>
<td>DFI</td>
<td>Development Fund for Iraq</td>
</tr>
<tr>
<td>FPS</td>
<td>Facilities Protective Services</td>
</tr>
<tr>
<td>IAMB</td>
<td>International Advisory and Monitoring Board</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>MoF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>OMB</td>
<td>Office of Management and Budget</td>
</tr>
<tr>
<td>PRB</td>
<td>Program Review Board</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>USG</td>
<td>United States Government</td>
</tr>
</tbody>
</table>
Appendix H. Report Distribution

Office of the Secretary of Defense

Secretary of Defense
Deputy Secretary of Defense
Under Secretary of Defense (Comptroller)/Chief Financial Officer
    Director, Program Analysis and Evaluation
    Deputy Chief Financial Officer
    Deputy Comptroller (Program/Budget)
Inspector General, Department of Defense
Director, Defense Procurement and Acquisition
Director, Defense Support Office - Iraq

Office of the Secretary of State

Secretary of State
Deputy Secretary of State
U.S. Ambassador to Iraq
Inspector General, Department of State
Director, Iraq Reconstruction Management Office

Department of the Army

Assistant Secretary of the Army, Acquisition, Logistics & Technology
    Assistant Secretary of the Army for Policy and Procurement
Auditor General, Department of the Army

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Iraq Project and Contracting Office

Other Federal Government Organizations

Office of Management and Budget
Government Accountability Office
Inspector General, Department of Commerce
Inspector General, Health and Human Services
Inspector General, U.S. Agency for International Development
Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Committee on Foreign Relations
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform
Appendix I. Audit Team Members

The Financial Management Division, Office of the Assistant Inspector General for Auditing, Special Inspector General for Iraq Reconstruction, prepared this report. Personnel who contributed to the report are listed below.

John Betar
Brian Flynn
Robert Murrell
Kevin Ellenberger
William Whitehead
Leona Brent
Ramon Miller
Mr. Stewart Bowen
Inspector General
Coalition Provisional Authority
Department of Defense
Washington, DC. September 8, 2004

Dear Mr. Bowen:

I am writing to you about the July 12 draft Inspector General's report entitled “Oversight of Funds Provided to Iraqi Ministries through the National Budget Process.”

In my view, this draft report does not meet the standards Americans have come to expect of the Inspector General. The draft contains numerous factual errors, which the Department of Defense Iraq Support Group and others have brought to the attention of the IG. I assume these will be corrected in the final report.

I want to focus on two major flaws in the draft report: the authors’ failure to understand and acknowledge the context in which the CPA was operating; and their failure to recognize the major steps the CPA took to address the admitted weaknesses of the Iraqi budgeting system.
A. The draft ignores the context of the CPA's role in liberated Iraq.

Security context: The draft report assumes that western-style budgeting and accounting procedures could be immediately and fully implemented in the midst of a war.

1. For example, the draft suggests that CPA should have delayed paying Iraqi public servants until we had fully modern pay records.

   This would have taken many months, if not years. More than a million Iraqi families depended on the Iraqi government for their salaries. When the CPA arrived in Iraq after Liberation, unemployment was over 50%. Not paying the civil servants would have been destabilizing and would have increased the security threat to Iraqis and to Americans. In brief, such a course would have cost lives.

2. At another point the draft report criticizes the Coalition's handling of Facilities Protection Service (FPS). Here again the draft misses the context.

   As a matter of American government policy, our military commanders were instructed to build up the FPS force quickly. The purpose of the FPS was to relieve the American military of tasks such as providing static security to government buildings.
This would free our military to deal with the terrorists.

In November, the CPA decided to give Iraqi responsibility for these security forces by shifting the forces’ payroll from the military commanders to the Iraqi Ministries. Many Ministries, already struggling to cope with the new budgetary demands, had difficulties making the transfer.

The CPA was aware of this problem and accepted that the payroll system was still imperfect. There was a war going on in Iraq, and it would have been dangerous for security—ours and Iraq’s—to stop paying armed young men.

The Political context: This is the report’s most significant fault. For the CPA’s entire period, American strategy was to transfer to the Iraqis as much responsibility as possible as quickly as possible, including responsibility for the Iraqi budget.

1. This was not just American Government policy. It was mandated by successive United Nations Security Council resolutions.
2. The CPA worked quickly to establish an Iraqi Governing Council. This was done within 8 weeks.
3. The CPA then pushed to get a new Iraqi Cabinet named quickly. Iraqi Ministers took over Iraq’s Ministries on September 3.
4. Contrary to the draft report's assertion, the guidance to CPA's Senior Advisors was clear. I told the CPA Advisors that henceforth the Iraqi Ministers, not the Advisors, would run Iraq's Ministries. The Advisors were to counsel the Ministers as requested by the Ministers but to leave the operations of the Ministries, including the budgets, to the Iraqis. I restated this policy directly to the Iraqi Ministers in my first meeting with them in September.

5. The draft suggests that instead of giving the Iraqi Ministers responsibility for their budgets, the CPA should have placed hundreds of CPA auditors into the Ministries. This would have been directly contrary to US government policy and to the mandate of the UN.

Administrative context: The IG auditors presume that the Coalition could achieve a standard of budgetary transparency and execution which even peaceful Western nations would have trouble meeting within a year, especially in the midst of a war. Given the situation the CPA found in Iraq at Liberation, this is an unrealistic standard.

1. When the CPA was established, there was no functioning Iraqi government.
2. Essential services in Iraq were primitive or non-existent. There was no national telephone system. Most Iraqi ministries had no computers. Use of the internet, which the previous government heavily
restricted, was limited to less than 3% of the population.
3. Iraqi government budget and personnel records, already inadequate before the war, had been destroyed by looting and by willful criminal sabotage.
4. As the GAO has reported, Saddam's dictatorship treated the national budget and economic statistics as state secrets. CPA determined that less than 8% of the annual state expenditures were even run through the Ministry of Finance. The vast majority of government expenditures were directly controlled "off budget" by the Presidency. We could find no reliable records of these expenditures.
5. The CPA discovered that the Iraqi Ministries had no regular payroll systems. Nor was there a unified civil service pay system. The system had been corrupted beyond repair by decades of cronyism and ad hoc fixes.
6. At Liberation, the Iraqi economy was dead in the water. So CPA's top priority was to get the economy going. The quickest way was to pay the country's 1.2 million civil servants who had not been paid for two months. Within a week of arrival, the CPA established a four grade pay scale and started paying civil servants. We also established an Iraqi-Coalition task force to design a modern, professional civil service pay system. This was put in place in August, 2003.
The draft report does not adequately credit the major reforms the CPA instituted to deal with the deficiencies we found in the Iraqi budgeting system. Certainly there was still much to do after the occupation ended. But this draft fails to acknowledge the important steps the CPA took to get the process moving.

**The Program Review Board (PRB)**

1. The CPA established the Program Review Board to provide an open transparent mechanism for determining how to spend monies from the Development Fund for Iraq (DFI). From the start, the CPA took the initiative to ensure that there was Iraqi representation on the PRB to give Iraqis a share of responsibility for that spending.
2. The minutes, budget and DFI funds balances were regularly posted on the internet.
3. The CPA strengthened the Iraqi role in the PRB in the run-up to sovereignty and required Iraqi Ministries to come and defend their budget requests.

**Fighting corruption**

1. In September, the CPA established an independent judiciary for the first time in Iraq's history.
2. The CPA established an office of Inspector General in every Iraqi Ministry, and gave the IGs significant authorities and budgets independent of their Ministries.
3. The Coalition set up an Iraqi Commission on Public Integrity with authority to investigate and prosecute allegations of corruption.

4. The CPA revitalized and strengthened the Iraqi Board of Supreme Audit, a respected organization which is the rough equivalent of the American GAO.

Improving Iraqi capabilities

1. The CPA introduced a Financial Management Information System to begin modernizing the Iraqi government’s procedures.

2. The Coalition encouraged the World Bank to set up training programs on fiduciary matters in the ministries.

3. The CPA encouraged the IMF to establish a program to restructure the chart of accounts.

It is remarkable that the Inspector General’s office could have produced even a draft report with so many misconceptions and inaccuracies. And remarkable that such a draft could have been written without the authors interviewing any of the three CPA Directors of Budget, the CPA Chief of Staff, either of my Deputies, or me.

As you know, I have been a strong supporter of your office since Congress established it. On the whole, the office has done excellent work. But I do
believe my colleagues at the CPA have a right to expect a level of professional judgment and awareness which seems to be missing in the current draft report.

I hope that as you continue your important mission on behalf of the American people in support of the Iraqi people, you and your colleagues will find these comments useful.

Sincerely,

Ambassador L Paul Bremer III
October 07, 2004

MEMORANDUM FOR THE INSPECTOR GENERAL OF THE COALITION PROVISIONAL AUTHORITY (CPA-IG)

FROM: Director, Defense Support Office - Iraq

SUBJECT: OSD COMMENTS TO ACCOMPANY AMBASSADOR L. PAUL BREMER’S COMMENTS ABOUT THE CPA-IG DRAFT REPORT “OVERSIGHT OF FUNDS PROVIDED TO IRAQI MINISTRIES THROUGH THE NATIONAL BUDGET PROCESS” (PROJECT NUMBER D2004-DCPAAF-0007)

This memo provides management comments on your draft report, “Oversight of Funds Provided to Iraqi Ministries through the National Budget Process,” dated July 12, 2004. We appreciated meeting with your auditors on July 28, 2004, and believe these written comments to be consistent with our representations at the meeting. We also appreciate that you recently interviewed Ambassador Bremer and senior Coalition Provisional Authority (CPA) staff as an important step toward ensuring completeness of the audit.

We strongly object to the draft report’s conclusion that the CPA did not provide adequate and transparent stewardship of Development Fund for Iraq (DFI) funds disbursed to Iraqi ministries. We believe this sweeping and unqualified conclusion is neither an accurate representation of the CPA management of the DFI nor is it substantiated by the findings, which relate to only one aspect of the CPA’s stewardship of the DFI—oversight of the Iraqi ministries’ execution of these funds. The CPA’s stewardship of the DFI resulted in numerous accomplishments that are not reflected in this audit of such narrow scope.

Additionally, in our view, a conclusion concerning the CPA’s stewardship of the DFI needs to be preceded by essential facts that put the conclusion in context. These include:

• The fact that the DFI was comprised entirely of Iraqi funds being returned to the Iraqis through an open process with significant Iraqi participation.
• The difficult circumstances under which the CPA operated and managed the DFI, including particularly the wartime security conditions, the CPA’s critical need to reestablish Iraqi ministries that had never functioned and/or had ceased to function, the ministries’ lack of basic tools such as computers and telephones, and the constraints of a largely cash economy.
• The US Government (USG) and the CPA policy objectives – consistent with UN Security Council Resolutions – to transfer administrative responsibilities for the Iraqi ministries to an Iraqi administration as an essential part of the restoration of Iraqi governance authority.
• The reality that during the CPA-IG’s preparation of the audit, the CPA was in the process of instituting financial processes and controls. In this respect, the CPA-IG was auditing work in progress, not the final results of the CPA’s efforts.

Furthermore, the audit does not take into account that the CPA exercised its stewardship of the DFI through many initiatives designed to ensure transparency in the use of Iraqi funds. Under the previous regime, Iraqi funds were used in a secretive manner to benefit Saddam and his regime. Under the CPA, Iraqi funds (principally the DFI) were allocated, disbursed, and used in a transparent manner for the benefit of the Iraqi people. In August 2003, the CPA promulgated detailed procedures applicable to the expenditure of Iraqi funds through contracts and grants. These procedures were approved by the Coalition governments, the international financial institutions, and the Interim Iraqi administration, and are consistent with internationally accepted public fund execution standards. The CPA disbursed funds to the Iraqi ministries consistent with a published National Budget (jointly developed by the CPA and the Iraqi Ministers and approved by the Iraqi Governing Council) and the recommendations of the CPA Program Review Board (PRB). The PRB’s minutes, the National Budget, and the DFI fund balances were posted on the CPA’s public web site. Further, there were important, observable results from disbursing funds to the Iraqi ministries – the employees were paid, the ministries resumed operations; and, importantly, the Interim Iraqi Government therefore had functioning ministries at the transition of governance on June 28, 2004.

Moreover, the CPA took a number of actions that improved the Iraqi government budgeting and financial management. These included:

• Establishing a functioning budget process; writing a budget law, and beginning to restructure the chart of accounts to conform to International Monetary Fund (IMF) budget standards.
• Promoting accountability and combating corruption, including re-establishing Iraq’s Board of Supreme Audit, creating the Commission on Public Integrity, and establishing Inspectors General in each ministry.
• Contracting for a Financial Management Information System for the Ministry of Finance and other ministries that, when complete, will provide the expenditure tracking called for by the audit.

None of these initiatives appears to have been acknowledged or given weight by the auditors – despite the “Audit Comments” noting that the CPA-IG was providing no recommendations because corrective management actions had already been taken during the audit period. Moreover, the audit’s conclusion appears to have been based on two judgments that were principally about policy, rather than management.

First, the audit does not recognize that the CPA – consistent with international law and as part of its objective, consistent with UN Security Council resolutions, to transfer responsibilities to Iraqis as soon as possible – took the consistent position that expenditures by Iraqi ministries were to be managed by the Iraqis and, over time,
overseen by Iraqi auditors. The audit faults the CPA for failing to provide adequate stewardship of the DFI funds at the Iraqi ministry level without recognizing the CPA's obligations, including under UN Security Council Resolution 1511, to ensure that the administration of Iraq was progressively undertaken by structures of the interim Iraqi administration, as well as the CPA's obligation to return governance responsibilities and authorities to the people of Iraq as rapidly as practicable. Consistent with international law and applicable UN Security Council resolutions, it was USG policy to give the Iraqis as much control of the ministries as practicable—beginning with the appointment of Interim Ministers in September 2003. This included Iraqi control of expenditures in accordance with the National Budget. This policy was a necessary step toward restoration of a sovereign Iraqi government.

Second, the audit concludes that the CPA did not meet the transparency requirements of UN Security Council Resolution 1483, without articulating any appropriate standard on which this judgment is based and without any analysis showing how the CPA-IG evaluated applicable obligations under Resolution 1483. In fact, the CPA, in accordance with UN Security Council Resolution 1483, disbursed DFI funds to the Iraqi ministries in a transparent manner for the purposes reflected in the Iraq National Budget to benefit the Iraqi people. The draft audit disregards the uncontested fact that the CPA took a number of actions to ensure transparency (publishing the minutes from PRB meetings, publishing the Iraqi National Budget, including Iraqis in the PRB, etc.), focusing only on the unavailability of near real-time budget execution data. The measures to ensure transparency were consistent with USG obligations under Resolution 1483.

We agree that the CPA faced managerial, financial, and contract challenges, given the numerous difficulties inherent in the establishment of a coalition organization exercising governance authority, the historic nature of its tasks, and the requirement to fulfill its vital mission in a combat zone. The CPA acted to address these challenges. In this light, we disagree strongly with the conclusion that, because of policy decisions regarding Iraqi management of the execution of the Iraqi funds, the CPA failed to meet objective standards for transparent stewardship of DFI funds. The attached General and Specific Comments provide additional detail.

We request that you reconsider the draft report in light of Ambassador Bremer's assessment of the audit as well as the comments I am providing herein. We have suggested language in section III (Conclusion) attached that is consistent with the limited scope and findings of the audit, and that recognizes the CPA's accomplishments under extremely difficult circumstances.

Joseph A. Benkert
Deputy
1. General Comments

1. The Draft Report Fails to Account for the Objectives of USG Policy

The draft report does not recognize that the CPA – for the important reasons discussed above – took the consistent position that expenditures by the Iraqi ministries were to be managed and overseen by the Iraqi interim administration. The CPA realized that the only practicable approach to executing the expenditures needed for Iraq was to assume a supervisory role and to empower the Iraqi ministries as necessary both to meet the needs of the Iraqi people and to enable the development of Iraqi governmental institutions. This approach was fully consistent with the CPA’s roles and obligations under UN Security Council Resolutions 1483 and 1511 to transfer the administration of Iraq progressively to the evolving structures of the Iraqi interim administration, and to return governing responsibilities and authorities to the people of Iraq as soon as practicable.

The alternative would have been to institute a new system that would have delayed vital expenditures for months and would not have involved Iraqis to the extent necessary to achieve important objectives in Iraq. Such a delay would have further exacerbated an already challenging security environment and would have hindered the fulfillment of the governance obligations noted above. Additionally, the draft report fails to acknowledge that such alternatives would have required a huge addition to the CPA staff to run the Iraqi ministries, or a system (likewise with major staff increases) by which the Coalition would directly control all the DFI expenditures until the Iraqi ministries were fully able to meet international accounting standards. Neither of these options made sense given the CPA’s obligations and the important objective of moving as quickly as possible to transition to Iraqi governance authority. Finally, although the CPA-IIG auditors told DoD officials that the draft report was a snapshot in time as of April 2004, there is no acknowledgement in the draft report that great efforts were being made to prepare the Iraqi Ministries to function competently upon transition to full governance authority just two months later.

2. The Draft Report Does Not Recognize the CPA’s actions to establish Financial Management Controls and Its Promotion of Transparency and Good Governance

The draft report excludes multiple CPA actions to establish financial management controls over DFI resources and increase the transparency, effectiveness and accountability of Iraq’s government. Specifically, the CPA:

- Promulgated CPA Regulation No. 2 in order to place responsibility with the Program Review Board (PRB) for reviewing competing requirements for the relief and recovery of Iraq, assessing available resources, and developing a comprehensive budgetary framework that identified prioritized requirements for proposed disbursements from the DFI.
- Promulgated CPA Regulation No. 3 to establish the PRB "to ensure that funds . . . available to the CPA . . . are managed in a transparent manner." Since August 2003, PRB members met on more than sixty separate occasions to review and vote on funding requests. In order to ensure transparency, these decisions were posted on the CPA's web page.

- Developed and published CPA Memorandum No. 4 regarding contracting and grant procedures in order to ensure that Iraqi funds were expended transparently and in accordance with internationally accepted procurement standards. These standards applied to the Iraqi ministries unless the CPA determined that a ministry's contracting procedures were sufficient to ensure the transparent use and management of Iraqi funds. The Defense Contract Audit Agency (DCAA) did review contracting capabilities in three ministries, but DCAA was not able to review all the ministries and at the same time meet other high-priority requirements, such as performing contract audits or projects resourced with USG appropriated funds.

- Published Iraqi National Budget data, PRB meeting minutes, and DF1 fund information, including receipts, disbursements, and fund balances on the CPA's web page.

- Initiated economic reform initiatives through the US Agency for International Development's (USAID's) contract with Bearing Point.

- Worked with the Iraqi Ministry of Finance to automate the Iraqi public expenditure process through the development of a Financial Management Information System (FMIS) to be used by the Iraq Ministry of Finance and the other Iraqi ministries.

- Promulgated CPA Order No. 19 in order to ensure the independence of the Central Bank of Iraq (CBI). The CPA worked with the CBI and the Iraqi Ministry of Finance to execute a huge Iraqi currency exchange program successfully.

- Assisted the Iraqi ministers with the development and execution of their programs. Some of the key CPA staffs assigned to support the ministries had budget analysts assigned to assist the Iraqis. Although the CPA tried to recruit additional budget analysts, the security situation in Iraq made such efforts extremely difficult and limited the assistance the CPA was able to provide to the Iraqi ministries in their budget execution.

- Worked with the USG, the Coalition governments, and the international financial institutions, as well as the Iraqis, to develop and promulgate orders establishing a new financial management law for the national budget, a new procurement law, a revised law strengthening the Board of Supreme Audit, and a law providing for inspectors general for the Iraqi ministries.
• Used the DoD Financial Management Regulation (DoDFMR) as a guide in developing program controls and forms for the disbursement of DFI funds.

3. The Draft Report Reaches Overly Broad Conclusions Based on Limited Findings

The draft report includes broad, unvalidated statements based upon limited reviews and unclear standards of performance.

• The audit methodology extrapolates from a "snapshot" of the activities of fewer than half of the CPA's senior advisors, over a span of several weeks near the end of the CPA's tenure, to reach conclusions on the performance of CPA as a whole over the CPA's entire tenure. Indeed, only 9 of the 26 senior advisors' offices were reviewed. Some CPA senior advisors were new in their positions and were not on the CPA staff when the CPA worked with the Iraqi ministries to develop the Iraq National Budget. Furthermore, during the time the audit was conducted, all CPA senior advisors were focused on the critical requirement of transitioning governance responsibilities to the Iraqi ministries.

• There is little evidence in the draft report of direct contact with the Iraqi ministries themselves, particularly the Ministry of Finance. Had the CPA-IG auditors interviewed Iraqi officials responsible for the management and disbursement of the Iraq National Budget, they could have attempted to obtain information on the status of the $8.8 billion, including how much had been distributed by Iraqi ministries for their operating and capital budget requirements, how much is still on hand in Iraqi ministry bank accounts, and how much had been expended for government salaries and for other purposes.

• The salary discussion in the draft report cites a single instance of poor management of the Facilities Protection Service (FPS) and generalizes that all salary payments were flawed. The FPS represented 74 thousand employees, representing approximately six-tenths of one percent of the 1.2 million Iraqis on the national payroll. Furthermore, the FPS was a unique case in that the overriding priority was for the FPS to be established as soon as possible in order to begin relieving the pressure on Coalition Forces for providing fixed-site security. In this vein, the CPA and DoD recognized that although it was necessary to entrust Iraqi ministry officials with the responsibility for expending Iraqi funds for salary purposes, such action could result in potential duplicate or otherwise improper payments. It was also understood, however, that placing sufficient Coalition Forces and CPA personnel at the multitude of payment locations across the country to verify Iraqi government employee identification numbers versus employee listings would be impractical, would likely be more expensive than accepting some risk of improper payments, and would pose significant force protection risk.

• The CPA-IG properly identified internal control problems within the Iraqi ministries in the disbursement of their budgeted resources (which included not only funds disbursed from the DFI, but also seized and vested funds disbursed to the Ministry of Finance for budget requirements and cash existing in the Iraqi national banks that was not seized by
coalition forces. These findings, however, are not a basis for concluding that the CPA did not provide adequate stewardship of $8.8 billion in DFI funds.

II. Specific Comments

OSD Comment 1:
Page 4

- The section on "Managerial Controls" asserts the CPA did not staff the Ministry of Finance/OMB advisors with sufficient personnel. Although additional staff might have been helpful, the analysis on page 4 does not provide any indication of how many personnel would have been sufficient to provide the level of oversight called for in the draft report. Further, although it is generally acknowledged that there were practical and logistical constraints on the total number of CPA staff, there is no evidence that any MOP/OMB advisor staffing request was denied by the CPA. Indeed, the CPA Human Resources Office attempted to recruit additional budget analysts with some success.

OSD Comments 2& 3
Page 2

- Contrary to the final sentence under "Contracting Procedures," at least one other ministry (the Ministry of Electricity) besides the Ministry of Finance had been approved for contracting.
- The scope of the draft report changed without explanation. Under the section titled "Objective" it is stated: "The original objective of the audit was to determine whether the Coalition Provisional Authority has implemented adequate procedures for recording, reviewing, and reporting DFI disbursements. During the audit, we limited the scope to review procedures and controls over DFI funds provided to the interim Iraqi government through the national budget process."

OSD Comment 4
Page 3

- Under the section titled "Managerial Controls," there is an indication that some senior advisors claimed that the CPA guidance pertaining to the DFI was unclear. No evidence is provided, however, to support that the alleged lack of clarity resulted in "inadequate" oversight. Furthermore, the CPA staff members responsible for DFI disbursements were clear on the policy and procedures for DFI administration. They ensured that the disbursements from the fund were properly approved and documented and were made in a transparent manner for the benefit of the Iraqi people.

OSD Comment 5
Page 5
• The following statement in the draft report should be put in the proper context. "According to CPA Ministry of Finance/OMB officials, reviewing budget execution was not their responsibility." Consistent with applicable UN Security Council resolutions and international law, USG policy guidance, and practical and political limitations, the Iraqis were given responsibility for their ministry budget execution. As a consequence of this appropriate role for the Iraqi ministries, there was necessarily a more limited role for CPA senior advisors in budget execution. Again, during the period in which the audit was conducted, ministry senior advisors were rightly focused on efforts to transfer complete governance authority to the Interim Iraqi Government.

OSD Comments 6, 7, & 8
Page 6

• It is necessary to comment also on the following statement: "CPA officials authorized payments of DFI funds for 74,000 Facilities Protection Services (FPS) guards’ salaries even though the FPS and number of guards was not validated." The statement is made without mention of the extenuating circumstances requiring payment of the salaries on a timely basis. At the time, prompt payment was considered to be absolutely vital to the safety and well-being of the FPS guards and the Iraqi people in general. Without adequate qualifications, a reader might mistakenly believe that the decision to pay salaries without more extensive validation procedures resulted from carelessness on the part of CPA, which was not the case.

• The section titled “Salary Payments” implies evidence of payroll irregularities, yet is unclear on the details of when and how these irregularities occurred, and fails to note whether the CPA-IG referred these examples to an appropriate investigatory body. Lack of documentation within the Ministry of Finance is cited, but there is no evidence of whether the CPA-IG sought this information from the disbursing entities.

• In the section titled “Transparency,” there is the statement that “transparency requires more than posting budgets and total disbursements on the Internet,” yet fails to present an international standard for transparency against which the CPA is being evaluated. As Ambassador Bremer’s letter states, the draft audit presumes the CPA could achieve within one year a standard of budgetary transparency and execution that even Western nations would have trouble meeting, especially in a combat environment.

OSD Comments 9 & 10
Page 7

• As part of the “Transparency” section, the following statement is made: “Although the UN provided $2.5 billion dollars to the DFI in March and April 2004, the CPA did not update the Iraqi National Budget to reflect budget plans for those monies.” This statement is not correct. In fact, the CPA did produce an updated working copy of the budget that was validated and shared with the Iraqi Ministry of Finance. When asked, Interim Iraqi Government officials indicated a preference that the CPA not officially
publish the amended budget that had been prepared. Rather, they preferred to leave final
decisions regarding an amended budget to the new sovereign government. Their wishes
were honored.

• It is necessary to comment on the following statement: “An improper $120 million
disbursement was made in May 2004 because of communication between the
CPA/OMB and Comptroller’s office.” This statement is misleading. A
miscommunication led to $120 million being released a month early. Without adequate
description, a reader could conclude that a $120 million disbursement was made that
would otherwise never have been made. In fact, the disbursement would have been made
the following month. Only the timing was in error.

OSD Comment 11
Page 9

• The discussion of the post-July contract management procedures appears to be
mistaken, citing a July 1 action that post-dates the audit period.

OSD Comment 12
Page 10

• The section titled “Audit Comments” notes that no recommendations are provided
because actions had been taken that should correct the problems. These corrective
management actions, however, were taken within the audit period. Therefore, they
should be reflected throughout the body of the draft report, not just in the “Audit
Comments” section at the end of the report.

III. Conclusion

Our suggested conclusion is as follows:

The CPA disbursed funds from the DFI based upon Program Review Board
recommendations of individual relief and reconstruction projects and operating and
capital expenditure requirements in the Iraqi National Budgets that were approved by the
interim Iraqi administration. We note concerns regarding the oversight and
documentation of DFI fund expenditures by the Iraqi ministries. However, operating
within constraints inherent in the combat environment in which it carried out a historic
mission, the CPA established financial management controls consistent with the
applicable U.N. Security Council resolutions and international law.
MEMORANDUM FOR DISTRIBUTION

March 3, 2005

SUBJECT: Errata Page Insert, Special Inspector General for Iraq Reconstruction Report No. 05-004, “Oversight of Funds Provided to Iraqi Ministries through the National Budget Process,” January 30, 2005

We are adding page 3 of the Management Comments from the Director, Defense Support Office – Iraq to the report as an errata page insert. Page 3 was inadvertently omitted from the report and should be added to fully reflect the Director’s entire management comments to the report. The Director’s comments on the errata pages were addressed in our representation of management comments in the report. Please insert the attached errata page as page 42a of the report.

If you have any questions on the change, please contact Mr. James P. Mitchell at (703) 428-1217 or jpmitchell@cpaig.mil.

Attachment(s):
As stated