

Development Fund for Iraq

**Report of Factual Findings
in connection with Disbursements**

For the period from 1 January 2004 to 28 June 2004

**KPMG Bahrain
September 2004**

This report contains 27 pages



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Report of Factual Findings **in connection with Disbursements**

To the International Advisory and Monitoring Board of the
Development Fund for Iraq
To Project and Contracting Office
(successor to the Coalition Provisional Authority)

We have performed the procedures enumerated in the attached Appendix, which were agreed with the International Advisory and Monitoring Board of the Development Fund for Iraq and the Coalition Provisional Authority, solely to assist you in evaluating the Development Fund for Iraq's compliance with United Nations Security Council Resolution (UNSCR) 1483 paragraph 14, for the period from 1 January 2004 to 28 June 2004. The Coalition Provisional Authority was responsible for the Development Fund for Iraq's compliance with UNSCR 1483.

This Agreed-Upon Procedures engagement was conducted in accordance with the International Standard on Related Services 4400: Engagements to Perform Agreed-Upon Procedures Regarding Financial Information and with the International Organization of Supreme Audit Institutions (INTOSAI) Standards on Government Auditing.

The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described in the Appendix, either for the purpose for which this report has been requested or for any other purpose.

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1 Key internal controls at the CPA over disbursements to, and on behalf of, Iraqi Ministries

1.1 Procedure

We documented the key internal controls implemented by the Coalition Provisional Authority (CPA) over the disbursement of resources to, and on behalf of, the Iraqi Ministries. Iraqi Ministries consist of Ministries and other governmental organizations responsible for implementing programs for which disbursements from the Development Fund for Iraq (the "Fund" or "DFI") are made.

1.2 Key internal controls

1.2. The 2004 Iraqi National Budget was issued in October 2003 for the period from January to December 2004 and subsequently revised in March 2004. The budget was prepared using existing systems, forms and formats traditionally used in Iraqi budgets and prepared by each Ministry, in consultation with CPA Senior Advisors. The proposed budget was then reviewed by appropriate officials from the Iraqi Ministries of Finance and Planning, recommended for approval by the CPA Program Review Board (PRB) and approved by the CPA Administrator.

1.2.2 The PRB was responsible for recommending expenditure of resources from the Fund and other sources to the CPA Administrator for projects not included in the 2004 Iraq National Budget. The PRB was also responsible for reviewing all identified resource requirements, and their subsequent prioritization and integration into a funding plan. The funding plan forecasts available resources, recommends allocation of these resources and justifies the proposed expenditures and the recommended manner of expenditures. All funding plans and programs were to be recommended for approval by the PRB prior to approval by the CPA Administrator.

A Program Review Committee was established by the PRB to assist the CPA and Iraqi officials in coordinating programs prior to submission to the PRB. However, minutes of the meetings were not kept.

CPA Regulation 3 dated 15 June 2003, stated that all programs were to be approved, on a majority basis, by eleven voting members of the PRB, including one Iraqi representative from the Ministry of Finance (MOF). During 2004, one additional Iraqi voting member was added to the PRB. CPA Regulation 3 also stated that the PRB could only take official actions in formal sessions at which no fewer than 70% of the voting members of the Board are present.

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All programs recommended by the PRB, approved by the CPA Administrator and requiring contractual assistance, were to be transferred to the CPA Contracting Unit (CU). The role of the CU was to issue a Request for Proposal, evaluate bids received, award the contract and subsequently monitor performance of the contractor as set out in CPA Memorandum 4.

Competition for contracts in excess of \$500,000 was mandatory and three bids were to be obtained, unless circumstances required the award of a contract without competition, in which case written justification was to be documented in the contract file. A Technical Committee appointed by the CU officer, consisting of three or more officials, was to review the technical aspects of bids received.

PRB programs approved by the CPA Administrator and disbursements made by the CPA on behalf of the Iraqi Ministries under the 2004 Iraqi National Budget were subject to prior approval by Contracting Officers or other CPA officials.

Prior to contracting and disbursement by the CPA on behalf of the Iraqi Ministries, CPA Senior Advisors to the Iraqi Ministries were to authorize Allocations of Funds from the 2004 Iraqi National Budget, stating the budget line item from which funds were to be allocated.

Disbursements were to be made to the MOF in accordance with the 2004 Iraqi National Budget. Prior to disbursing funds to the MOF, final approval was required by the CPA Administrator. The MOF is responsible for disbursing funds to the Iraqi Ministries and Provincial Treasuries.

Disbursements for irrevocable documentary letters of credit (LCs) were to be organized by the Trade Bank of Iraq. CPA Senior Advisors were to approve funding requests and submit them to the Comptroller's Office for authorization to disburse funds.

1.2.10 Commander's Emergency Response Program (CERP) funds approved under PRB programs were subject to control under CPA Memorandum 4 – Appendix E (Fragmentary Order (FRAGO) 89), supplemented under additional FRAGOs issued by the United States Armed Forces and “Guidance on the use of the DFI in Support of the CERP” issued by the CPA.

1.2.1 Rapid Regional Response Program (RRRP) funds approved under PRB programs were subject to control under PRB Guidance 6 issued by the CPA and Funding Guidance issued by the CPA Comptroller's Office.

1.3 Findings

1.3.1 Key internal controls tested with our findings are noted in sections 2 and 6.

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2 Authorization by the CPA of disbursements to Iraqi Ministries

2.1 Procedure

For all disbursements to the Iraqi Ministries, we determined whether DFI funds disbursed by the CPA were properly authorized in accordance with the CPA's policies and procedures and whether there was documentation of receipt of such disbursements by each Iraqi Ministry.

2.2 Findings

2.2. Iraqi Ministries were primarily funded by the DFI during the period from 1 January 2004 to 28 June 2004.

The CPA distributed DFI funds directly to the MOF in accordance with monthly funding requirements agreed by the CPA and the MOF. Thereafter, DFI funds were redistributed by the MOF to other Iraqi Ministries in accordance with the 2004 Iraqi National Budget. We agreed the following disbursements from the DFI to the MOF accounting records during the period from 1 January 2004 to 28 June 2004:

January	\$ 727,775,529
February	508,812,129
March	900,000,000
April	600,000,000
May	530,000,000
June	<u>1,791,400,000</u>
	<u>\$ 5,057,987,658</u>

We also agreed these disbursements (11 in total) to the MOF bank account, denominated in US dollars, at the Central Bank of Iraq

We were informed by the CPA that transfers in June 2004 were larger than previous months to ensure the Interim Government of Iraq had sufficient funds to meet obligations subsequent to the transfer of authority. Included in the June disbursement is \$766,400,000 for the July budget.

The individual disbursements to the MOF were authorized by the CPA Comptroller and the CPA Chief of Staff.

The CPA Administrator approved \$193,412,342 more than was disbursed to the MOF due to disbursements also being made by the CPA on behalf of the MOF to third parties requiring wire transfers. We were not provided with a reconciliation of the total funds disbursed on behalf of the MOF to amounts deducted from the monthly budget authorizations. We were not provided with the monthly budget authorization, which was to be approved by the CPA Administrator, for May 2004.

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2.2.5 As noted above, we were able to agree amounts transferred from the DFI to the MOF bank account and accounting records. We were also able to agree funds transferred by the MOF to bank accounts and accounting records at three of the five Iraqi Ministries visited (Oil, Housing & Construction, and Trade). We reconciled funds transferred by the MOF to the bank accounts and accounting records at the Ministry of Electricity. We were unable to reconcile a difference of approximately \$610,000 of funds transferred by the MOF to the Ministry of Health. We noted additional issues in the internal control systems over accounting and financial reporting at the Iraqi Ministries, as detailed in section 4.

The Kurdish Regional Government (KRG) was primarily funded by the MOF during the period from 1 January 2004 to 28 June 2004. In addition, the CPA made direct disbursements to the KRG (including the Office of Project Coordination (OPC)) from the DFI, as follows:

January	\$ 21,300,000
May	120,000,000
June	235,500,000
June	<u>1,400,000,000</u>
	<u>\$ 1,776,800,000</u>

We were informed by the CPA that transfers in June 2004 were larger than previous months to ensure the KRG had sufficient funds to meet obligations subsequent to the transfer of authority.

During our procedures in Erbil, we were denied access by the KRG to their accounting records. However, we held meetings with the KRG Minister of Finance from Erbil and performed certain limited procedures at the OPC in Erbil as detailed below.

The OPC was established by the CPA to act as an intermediary body between the CPA and the two regional administrations forming the KRG, and was responsible for managing funds under the UN Oil For Food program.

2.2.8 We were able to agree \$355,500,000 of disbursements made by the CPA to the accounting records and bank statements of the OPC.

We were provided with a deposit slip for a Kurdish Bank by the OPC for the receipt of \$1,400,000,000. We were informed by the CPA Inspector General's Office that they were present during the delivery of the cash to Erbil as part of their audit procedures.

2.2.10 The January 2004 disbursement of \$21,300,000 to the KRG represented the correction of an arithmetical error in the 2003 Iraqi National Budget. We agreed this disbursement to supporting documentation.

2.2.11 The individual disbursements to the KRG were also authorized by the CPA Comptroller and the CPA Chief of Staff.

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2.2.12 We found that payments made to the KRG were approved by the CPA Senior Advisor to the MOF rather than the CPA Administrator. We were informed by the CPA Senior Advisor to the MOF that disbursements from the 2004 Iraqi National Budget did not require additional approval from the CPA Administrator.

2.2.13 The 22 June 2004 disbursement made by the CPA for \$1,400,000,000, was allocated to the MOF operating budget line item 'transfer payments', as approved by the CPA Senior Advisor to the MOF. We were unable to obtain further analysis or information regarding the intended utilization of this budget line item.

2.2.14 The May and June 2004 disbursements of \$355,500,000 represent part of the KRG's share of the 2003 UN Oil for Food program transfers (\$5,600,000,000) to the DFI.

In addition, the CPA disbursed approximately \$259,000,000 on behalf of the KRG to support ongoing UN Oil for Food projects. These transfers were allocated under the budget line 'KRG Ongoing Projects' in the 2004 Iraqi National Budget.

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3 Key internal controls at the CPA over the monitoring process of disbursements made by Iraqi Ministries

3.1 Procedure

We documented the key internal controls implemented by the CPA over the monitoring process of disbursement of resources made by Iraqi Ministries.

Key internal controls

3.2.1 Each Iraqi Ministry was supplemented by a CPA Senior Advisor and their CPA staff, to oversee the Ministries' activities.

The disbursement of salaries was to be made in accordance with CPA Order 30 dated 8 September 2003, as supplemented by monthly instructions issued by the CPA and the MOF. Any action causing the increase of a Ministry's payroll costs over the previous month was to be approved by the CPA Senior Advisor to the MOF.

We were informed that the CPA mainly relied on the internal controls established at the Iraqi Ministries, including the work performed by the internal auditors of the MOF and the Iraqi Board of Supreme Audit (BSA), to ensure funds disbursed to Iraqi Ministries were utilized as budgeted.

3.3 Findings

Our findings are noted in sections 5 and 6.

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4 Key internal controls at Iraqi Ministries over disbursements

4.1 Procedure

We visited management and Inspector Generals of six Iraqi Ministries (Finance, Oil, Electricity, Trade, Health and Construction & Housing) and documented key internal controls, designed to ensure disbursement of resources from the DFI were utilized as intended.

Key internal controls

The MOF was responsible for redistributing DFI funds to Iraqi Ministries and Provincial Treasuries in accordance with their monthly individual budgets. Excess expenditure over monthly individual budgets was subject to authorization by the MOF Budget Department.

On a monthly basis, each Iraqi Ministry and Provincial Treasury was required to prepare a trial balance, revenue and disbursement reports, and bank reconciliations. These reports were to be submitted to the MOF Consolidation Department for review and consolidation.

The disbursement of salaries was to be made in accordance with CPA Order 30 dated 8 September 2003, as supplemented by monthly instructions issued by the CPA and the MOF. Any action causing the increase of a Ministry's payroll costs over the previous month was to be approved by the CPA Senior Advisor to the MOF.

Each Iraqi Ministry consists of a headquarter and several divisions, which include a number of departments (e.g. Accounting, Administration, Legal, Internal Audit & Planning). For each division, monthly payroll sheets were to be prepared by the Accounting Department with amendments to be approved by the HR Department, reviewed by the Internal Audit Department and approved by the head of department.

The Accounting Department was to prepare a summary of the monthly payroll sheets, which was to be reviewed by the Head of the Accounting Department. The summary was to be forwarded to the Minister or the Head of Division for approval.

After the summary was approved, a fund request letter was to be prepared by the Ministry or Division and sent to the MOF for authorization.

The payroll was to be disbursed, with each employee acknowledging receipt of salary by way of signature.

Disbursements for goods and services require different levels of authorization according to value. For disbursements in excess of Iraqi Dinars 10,000,000 (\$6,600) a tender process was to be undertaken, whereby three bids were to be received and the successful bidder was to be

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approved by an Award Committee and authorized by the Head of the Division. For requests in excess of Iraqi Dinars 75,000,000 (\$50,000) a public tender was to be required.

Technical and Financial Committees were to be appointed by the Minister. Depending on the contract value, the successful bidder was to be approved by the Head of the Division, the Deputy Minister or the Minister.

Complete disbursements to contractors were to be made only after goods were received or services rendered were approved.

- 4.2.5 Individual Iraqi Ministries and Provincial Treasuries were subject to audits by the audit function of the MOF (over 60 auditors) and the BSA (over 800 auditors).

4.3 Findings

- 4.3.1 The MOF maintained two sets of accounting records, manual records for transactions post-hostilities and computerized records representing the continuation of the official records. A reconciliation between these two sets of accounting records was not prepared and the difference was significant. The accounting systems at the Iraqi Ministries, including their divisions, were primarily manual based with limited computerization.

The current MOF accounting software has limited reporting capabilities, for example the MOF Accounting Department could not provide us with a consolidated disbursement report for each Ministry. We were informed by the MOF that a new financial management information system will be implemented as from 2005.

We found that reconciliations between amounts transferred from the MOF and amounts received by the Iraqi Ministries visited were not prepared. The MOF relies on the MOF Consolidation Department to detect unreconciled items and accounting errors. However, we found this control was not fully effective as we identified errors when reconciling MOF funds transferred to the Iraqi Ministry of Electricity (MOE) and to the Ministry of Health (MOH).

We performed reconciliation procedures at the MOE and we noted that seven disbursements were recorded incorrectly at the MOF with an absolute value of \$45,000,000. These accounting errors consisted of five incorrect postings, one unrecorded disbursement and one disbursement which was cancelled yet still recorded.

Disbursements from the MOF to the MOH for the period from 1 January 2004 to 28 June 2004 were lower than receipts recorded at the MOH by \$610,000.

We found that the MOH's trial balance did not balance by approximately \$1,300,000 at 28 June 2004.

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We noted the two MOF bank accounts, denominated in US dollars and Iraqi Dinars, at the CBI, and the main accounts at Al-Rasheed and Al-Rafidain banks, were not reconciled to the accounting records and differences were significant.

- 4.3.8 For disbursements to Provincial Treasuries, we were informed by the MOF that, due to security issues, Provincial Treasuries did not submit their monthly trial balances, revenue and disbursement reports, and bank reconciliations on a timely basis.
- 4.3.9 For disbursements made by the CPA on behalf of the Iraqi Ministries, we were informed by the MOF that the CPA provided them with disbursement reports, including supporting documentation, on a monthly basis. The MOF and other Iraqi Ministries did not record these payments in their own records.

We were informed by the MOF that there is an internal policy manual detailing the responsibilities of departments and accounting procedures. We were informed that the manual is not widely distributed to staff and there is limited formal training provided, especially for new staff.

- 4.3.11 Additional findings are noted in section 5.

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5 Procedures undertaken over disbursements made directly by Iraqi Ministries

5.1 Procedures

For a sample of disbursements for the period from 1 January 2004 to 28 June 2004 we visited the MOF, five Iraqi Ministries and the Office of Project Coordination in Erbil, performing the following procedures:

5.1 Compared payroll details for each employee to the accounting records and personnel file;

5.1.2 Determined whether the key internal controls, noted in section 4.2.5, for approving, bidding and awarding of contracts to which disbursements relate were followed;

Observed whether the contract and purchase invoice were signed and approved by an authorized person in accordance with the CPA's and the Iraqi Ministries' policies and procedures; and

Compared expenditure to goods received notes or other supporting documentation evidencing services rendered.

5.2 Findings

5.2.1 We performed procedures at the MOF (see our findings in section 4.3), five other Iraqi Ministries (Electricity (MOE), Health (MOH), Oil (MOO), Trade (MOT) and Construction & Housing (MOC)) and the OPC. We were only able to obtain approval from the Iraqi Government to access the Iraqi Ministries on 16 August 2004 and were denied access by the KRG to their accounting records.

Due to security issues, we were unable to perform procedures at the Ministries of Education and Interior. Additionally our procedures at the Ministry of Electricity were limited due to security threat. Other problems encountered at the Iraqi Ministries included limited resources due to security issues and limited working hours. These obstacles further limited our procedures.

5.2.2 We performed procedures covering approximately \$577,000,000 of disbursements made by the Ministries' Headquarters and Divisions visited. Additionally, we performed procedures for a sample of 20-30 employee salaries at a number of divisions.

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For our sample of disbursements from the Iraqi Ministries visited, we found that all payroll disbursements were in accordance with the accounting records and other supporting documentation.

5.2.4 For our sample of disbursements from the Iraqi Ministries visited, we found that all key internal controls over the approval of, bidding for and awarding of contracts, as noted in section 4.2.5, were followed, except for the following deviations:

- MOE - We found one case where a large contract (\$339,141,000) was not publicly tendered. We were unable to obtain evidence of how many contractors were invited to tender for this contract or bids received.

We also noted that the technical panel had less than two days to complete their review of bids received and produce an assessment. We were informed by the Ministry that the contractor with the shortest performance period was selected.

- MOO - We found that divisions performing construction projects did not have significant contracting activity, as projects were performed internally.
- MOH - We found three cases where contracts were not publicly tendered. In two cases, we were informed by the MOH that bids were sent to the CPA Senior Advisor to the MOH rather than the MOH.
- MOC - We found 14 cases where we were unable to obtain evidence of bidding procedures or sole-source justification. We were informed by the MOC that 11 of these contracts had been issued pre-hostilities and documentation had been 'lost or burnt'.
- MOC - We found one case where a lawsuit for \$667,000 had been brought against a division for breach of contract.
- MOT - We were not provided with a complete list of contracts issued by the Ministry during the period from 1 January 2004 to 28 June 2004.

For our sample of disbursements from the Iraqi Ministries visited, we found that all contracts and purchase invoices were signed and approved by an authorized person, except for the following deviations:

- MOH - We found that checks were made payable to the CPA Senior Advisor to the MOH, rather than suppliers. Reconciliation between payments made and contracts or evidence of goods received were not provided to us.
- MOH - We were informed by the MOH that cash was held with an Iraqi bank (\$4,988,086 as at 28 June 2004) to pay international suppliers. This account was funded by the MOH, managed by the CPA Senior Advisor to the MOH, but was recorded as an expenditure in the MOH accounting records.

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- We found three disbursements were made on the basis of requests for payment by the Senior Advisor to the MOH, without purchase invoices, goods received notes or contracts.

For our sample of disbursements from the Iraqi Ministries visited, we found adequate supporting documentation for goods received or evidencing services rendered, except for the following deviations:

- MOH - We found six cases where we were unable to obtain goods received notes for deliveries.

Office of Project Coordination / Kurdish Regional Government

During our procedures in the Kurdish region in Northern Iraq, we were denied access by the KRG to their accounting records. Accordingly, we were unable to perform the procedures required in section 5.1. However, we held meetings with the KRG Minister of Finance from Erbil and performed certain limited procedures at the OPC in Erbil, as detailed below:

- We were informed by the KRG that there were no disbursements from the \$1,400,000,000 transferred to the KRG on 22 June 2004. We were not provided with documentation to verify that these funds remained unspent at 28 June 2004.
- Of the \$355,500,000 noted in section 2.2.8, our procedures covered approximately \$62,100,000 of disbursements made by the OPC to the KRG under Memoranda of Understanding (MoU).

These disbursements were made regarding contracts transferred from the UN Oil for Food program to the DFI. We did not perform procedures over contracting activities for those contracts transferred from the UN Oil for Food program to the DFI on 22 November 2003.

The OPC established a control system for the MoU with the KRG, notably the receipt of monthly reports and the KRG being subject to periodic OPC audits. We noted that only one monthly report had been received and one audit had been undertaken during the period from the establishment of the OPC (22 November 2003) to 28 June 2004. We were unable to obtain the audit report.

On the dissolution of the CPA and the OPC, the remaining cash at the OPC (\$275,421,686) was transferred to the KRG.

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BSA Audit Reports on Provincial Treasuries

5.2.8 We engaged the Iraqi Board of Supreme Audit (BSA) to perform similar procedures as detailed in section 5.1 at eight of the 17 Iraqi Provincial Treasuries for the period from 22 May 2003 to 28 June 2004. The BSA was unable to obtain information from one of the Provincial Treasuries (Ramadi) due to severe security issues in the region. The main findings noted by the BSA are as follows:

- The BSA reported that total disbursements for the Provincial Treasuries visited during the period amounted to approximately \$1,000,000,000.
- There was no supporting documentation available at Provincial Treasuries for disbursements made by the CPA on behalf of the Provincial Treasuries.
- The BSA visited a number of project sites and verified existence of work performed by contractors.
- A number of projects were awarded at one Provincial Treasury on a sole source basis without justification.
- A number of goods received notes or evidence of services rendered were not available.
- Numerous disbursements to and from the Provincial Treasuries and their divisions were not recorded or incorrectly recorded by either party.
- Salary payments during 2003 were not consistently documented, particularly in the early months post-hostilities. The lack of appropriate documentation at the Provincial Treasuries resulted in employees not signing their payroll sheets upon receipt of salary and of employees being paid twice. The employees' grade / salary were not consistently documented.
- MOF instructions were to use an exchange rate of Iraqi Dinars 1,500 / \$1 and not actual rates. Certain transactions were recorded using rates other than the MOF rate.

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6 Testing of disbursements made on behalf of Iraqi Ministries

6.1 Procedures

For our samples of disbursements made by the CPA on behalf of the Iraqi Ministries, we performed the following procedures:

- 6.1.1 Determined whether the key internal controls, noted in section 1.2, for approving, bidding and awarding of contracts to which disbursements related to were being followed;
- 6.1.2 Observed whether the contract and purchase invoice were signed and approved by an authorized person in accordance with the CPA's policies and procedures; and
- 6.1.3 Compared expenditure to goods received notes or other supporting documentation evidencing services rendered.

6.2 Findings

- 6.2.1 Our procedures cover four categories of disbursements made by the CPA during the period from 1 January 2004 to 28 June 2004. Our findings, as detailed below, are split between these categories to enhance clarity. These include disbursements made under projects administered by the CPA (PRBs and other disbursements made on behalf of the Iraqi Ministries), letters of credit, the CERP program and the RRRP program.

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6.2.2 DFI payments made on behalf of the Iraqi Ministries to 28 June 2004 were as follows:

<i>Ministry of:</i>	<i>Project:</i>	
Oil	Import of petroleum products	\$ 1,891,058,000
Oil	Emergency pipeline repair	81,842,000
Oil	Restoration of oil infrastructure	67,593,000
Oil	Oil Infrastructure	62,857,000
Oil	Security	42,811,000
Electricity	Restoration of Iraqi electricity	551,295,000
Electricity	Reconstruction of power plants	126,969,000
Electricity	Purchase of electricity from Turkey	31,350,000
Electricity	Security of power lines	8,968,000
Trade	UN WFP food procurement	910,000,000
Trade	Food procurement	33,500,000
Trade	OFF - Wheat purchase	28,241,000
Trade	OFF - Certification	6,294,000
Trade	OFF - Coordination centers (refund)	(25,000,000)
Finance	OFF - Northern program	118,483,000
Finance	Iraqi media network	37,464,000
Finance	Iraqi banknote program	26,970,000
Finance	External debt reconciliation	13,216,000
Finance	Election assistance	9,599,000
National Security and Defense	Weapons & equipment	43,257,000
National Security and Defense	Firefighter equipment	5,206,000
Agriculture	Fertilizer	18,942,000
Agriculture	Credit program for local farmers	10,000,000
Agriculture	OFF - Equipment	8,047,000
Planning	PMO office construction	5,558,000
Awqaf (Religion)	Hajj pilgrimage	50,633,000
Various ministries	40 programs	64,877,000
 <i>Other:</i>		
Commander's Emergency Response Program (CERP)		354,781,000
Rapid Regional Response Program (RRRP)		<u>308,857,000</u>
		4,893,668,000
Letters of Credit (LCs)		725,730,000
Payments on behalf of Iraqi Ministries (mainly by LCs)		<u>558,540,000</u>
		<u>\$ 6,177,938,000</u>

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Projects administered by the CPA

Our sample comprised 58 funding plans (programs) and payments made on behalf of the Iraqi Ministries, which included 96% of the total value.

Further to the transfer of power from the CPA to the new Interim Government of Iraq, most CPA Senior Advisors and their staff left Iraq. Consequently, in certain cases we encountered difficulties in gathering evidence for the completion of our procedures, including obtaining supporting documentation for funding programs, projects or contracting files, and meeting with former staff responsible for these programs.

For our sample of project disbursements we found that all key internal controls for the funding approvals to which disbursements related were followed, except for the following deviations:

- We found one case where the approval of funds took place the day after the contract was signed (\$7,050,000).

6.2.6 For our sample of project disbursements we found that all key internal controls for the bidding on and awarding of contracts to which disbursements related were followed, except for the following deviations:

- We found 34 cases where disbursements and advance payments had been made to the United States Army Corps of Engineers (USACE) for import of petroleum products (\$983,704,969), restoration of oil infrastructure (\$67,573,813), restoration of Iraqi electricity (\$606,739,525) and other projects (\$41,482,614).

We noted that disbursements to the USACE were authorized by the PRB and approved by the CPA Administrator, under a series of Memoranda of Understanding (MoU). Under these MoU the USACE utilized DFI funds for new work approved by the CPA Administrator. We were informed by the USACE that the contract vehicle was several task orders added to existing contracts that had been openly competed well before the start of the CPA and also issued new contracts.

We had limited access to contracting procedures and documentation for contracts awarded by the USACE. However, we were informed by the USACE that their contracts were awarded with limited competition from the largest US construction companies. In one case, we were provided with written justification for the limited competition on the electricity contracts.

We noted that two contracts related to the restoration of oil infrastructure were transferred from the USACE to the Project Management Office, a US Government agency.

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- We found four cases where advance payments had been made to the Defense Energy Support Center (DESC) for fuel imports (\$645,000,000). We were not provided with access to contracting procedures, documentation or details of monitoring for contracts awarded by DESC.
- We found 37 cases where contracting files could not be located (\$185,039,313).
- We found one case where we were unable to obtain evidence of a tendering process (contract value of \$95,560,000). We were informed by the PCO (Project Contracting Office) that this contract was originally solicited on an openly competitive basis by the CPA in Washington DC, using Appropriated Funds. Additionally, we found that a progress payment of \$29,000,000 was made on 24 June 2004 with written justification dated on 21 July 2004.
- We found one contract where only two bids were received. We found that the respective CPA Contracting Officer was not aware of key elements of CPA Memorandum 4, notably the restrictions regarding a minimum of three bids on contracts (\$84,357,625).
- We found two cases where the Request for Proposal was publicized with a short deadline (less than five working days), resulting in only two bids being received. We noted documentation from other suppliers requesting extensions to the deadline. In both cases there was a one to three month delay between the deadline for submission of bids and the award of the contract to the successful bidder (\$10,689,547).
- We found two cases where documentation of the contract award decision was not available in the contracting file (\$97,574,185).
- We found four cases where the CPA Contracting Officer modified the CPA Standard Terms and Conditions to limit the effects of the CPA's standard indemnification clause. No documentation of the written justification for these alterations was found (\$102,237,185).
- We found six cases where purchase orders had been assigned to the CPA by the UN Food Agricultural Organization. We noted appropriate transfer documents for each case, however contracting files were not available at the CPA (total value \$36,772,526).
- We were unable to obtain an Availability of Funds document or contracts for the Hajj payments (\$50,633,000).
- We found one case where the CPA requested the acceleration of food shipment deliveries. Consequently, demurrage costs of \$12,400,000 (caused by the harbor operating at maximum capacity and being unable to unload the 12 ships) were incurred.
- We found one case where a contract was entered into despite the specific objections of the Iraqi representative to the PRB. No evidence of a bidding process was available, the

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contract was inappropriately signed by the CPA Senior Advisor (rather than a Contracting Officer) and an advance payment (\$2,915,000) paid without justification. The contract was later cancelled and the CPA Senior Advisor subsequently left the CPA.

- During our procedures at the OPC, we found four cases where contracts had been modified (for a total increase of \$39,740,993). These increases included \$33,223,596 for security costs in the Kurdish region, which was considered by the OPC to be relatively secure. We were informed by the OPC that they did not agree with these modifications. We were unable to obtain supporting documentation for the tender and award of these contract modifications.
- We found four cases where we were not provided with contract details or approval of funds for disbursements regarding letters of credit (LCs). However, we performed additional procedures at the Trade Bank of Iraq, the facilitator for LCs, and were able to obtain contract details and approval of funds for three cases. We were unable to obtain contract details for one disbursement of \$70,257,520.

For our sample of project disbursements we found that purchase invoices were signed and approved by an authorized person in accordance with CPA policies and procedures, except for the following deviations:

- We found seven cases where purchase invoices were not on file (\$6,935,786).
- We found two cases (\$5,070,000) where payments were made in full and contract files closed prior to the completion of the contract. In one of these cases, the file was closed before the commencement of the contract. We noted one additional case where an advance was made to a contractor without written justification (\$1,200,000).
- We found one case where a payment (\$2,600,000) was authorized by the CPA Senior Advisor to the Ministry of Oil. We were unable to obtain an underlying contract, evidence of tendering procedures or evidence of services being rendered. We have been informed by the PCO that this matter is under investigation.
- We found one case where we were unable to obtain evidence for the disbursement to the Iraqi Ministry of Agriculture for the credit program for local farmers (\$10,000,000).

For our sample of project disbursements we found adequate supporting documentation for goods received or evidencing services rendered, except for the following deviations:

- We found 52 cases where goods received notes or other supporting documentation were not on file (\$97,979,888).
- We found three cases where we were unable to obtain evidence of contract monitoring (\$22,136,560).

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- We found one case where a Contracting Officer Representative signed receiving reports for work carried out without verification of the services (security services throughout Iraq) actually provided (\$5,894,568).

Payments under Letters of Credit

Our sample comprised of 91 disbursements from the CPA to JP Morgan for 346 LCs (\$1,183,207,635). Each LC has a corresponding contract. We noted the following deviations:

- We were unable to obtain contracts or Approval of Funds, at the CPA, for 90 of 91 disbursements.

However, we performed additional procedures at the Trade Bank of Iraq. We were unable to obtain 14 contracts (\$209,088,466) for our sample of 81 (\$1,072,316,434) from 346 contracts.

Commanders Emergency Response Program

During the course of our procedures on the CERP program we noted the following:

- We noted that disbursements of \$350,482,493 were advanced to 21 Disbursing Agents, representing 11 military divisions. We noted an additional \$4,298,203 was directly disbursed to contractors.
- As of 13 August 2004, \$256,299,673 of paid vouchers had been cleared (i.e. returned remaining funds and / or vouchers to support disbursements) with the CPA Comptroller. For each of the 11 divisions, we tested 20 to 30 disbursements, covering 25% by value (245 of 7,784 disbursements) of total cleared disbursements.
- We noted that the CPA Comptroller's Office recorded only advance payments made to the Disbursing Agents. Detailed payment vouchers cleared by the Disbursing Agents were not entered into the CPA Comptroller's accounting database. We noted that a database was maintained by the United States Armed Forces, which contained detailed information on payment vouchers. However, we found that this database was not reconciled to the CPA Comptroller's accounting records.

During our procedures we found one case where a payment was recorded twice in the United States Armed Forces database (\$500,000).

- 6.2.1 For our sample of CERP disbursements tested we found that all key internal controls for the funding approvals to which disbursements related were followed, except for the following deviations:

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- We found four cases where we were unable to obtain formal, signed letters of appointment for Disbursing Agents.
- We found one case where the Allocation of Funds document did not specify the source of funding (\$123,000,000).
- We found nine cases where projects were not authorized at an appropriate level, as required under FRAGO (\$8,406,350).

6.2.12 For our sample of CERP disbursements tested we found that all key internal controls for the bidding on and awarding of contracts to which disbursements related were followed, except for the following deviations:

- We found 42 cases where there were no contracts on file for projects in excess of \$100,000, as required under FRAGO (\$13,283,352).
- We found 22 cases where we were unable to obtain evidence of monitoring by the CPA Regional Contracting Offices for contracts in excess of \$100,000, as required under FRAGO (\$6,086,776).
- We found 128 cases where we were unable to obtain evidence that three bids were obtained or sole-source justification for projects in excess of \$10,000, as required under FRAGO (\$31,682,067).

6.2.13 For our sample of CERP disbursements tested we found that purchase invoices were signed and approved by an authorized person in accordance with the CPA Memorandum 4 policies and procedures, except for the following deviations:

- We found 54 cases where we were unable to obtain either a purchase invoice or a payment voucher for a disbursement. Additionally, we found one case for which we were unable to obtain any supporting documentation for the disbursement. (\$7,190,944)
- We found a number of cases where weapons were paid for under a weapons buy-back program (\$1,400,000). The use of DFI funds for weapons buy-back programs was specifically prohibited by CERP rules and regulations.
- We found a number of cases where Iraqi Police salaries and Police Academy Student stipends were paid (\$220,000). The use of DFI funds to pay salaries for the civil work force was specifically prohibited by CERP rules and regulations.
- We found eight cases where advance payments, including advance payment of 100% of the contract value, were made for projects (\$3,450,000). CERP rules and regulations state that units were only to make progress payments based on contract performance.

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- We were informed by the CPA Comptroller of one case where \$774,300 was stolen from a division's vault. We were informed that a police investigation is ongoing.

6.2.14 For our sample of CERP disbursements tested, we found adequate supporting documentation for goods received or evidencing services rendered, except for the following deviations:

- We found 142 cases where we were unable to obtain receiving reports or other supporting documentation evidencing services received for payments made (\$39,957,782).

Rapid Regional Response Program

6.2.15 During the course of our procedures on the RRRP program we noted the following:

- We were provided with RRRP guidance subsequent to the completion of our procedures in Iraq. We were informed, as described in this guidance, that certain documents were to be retained at the CPA Regional Offices. Our procedures were performed only at the CPA Comptroller's Office in Baghdad and findings may not consider evidence that should have been retained by the CPA Regional Offices.

However, we noted that the RRRP funding guidance required contract / grant agreement, purchase invoice, receiving report and payment receipt to be submitted to the CPA Comptroller in Baghdad in order to clear funds advanced.

- We noted that disbursements of \$261,109,620 were advanced to 36 Disbursing Agents. We noted an additional \$47,747,259 was directly disbursed to contractors.
- As of 13 August 2004, \$163,831,650 of paid vouchers had been cleared with the CPA Comptroller. We tested 49% (466 of 3,063 disbursements) of total cleared disbursements by value.
- We noted that the CPA Comptroller's Office recorded only advance payments made to the Disbursing Agents. Detailed payment vouchers cleared by the Disbursing Agents were not entered into the CPA Comptroller's accounting database.

We were informed that the CPA Comptroller's office has begun the reconciliation of disbursements cleared by the Disbursing Agents. As of the date of this report, a complete database of disbursements was not available. We were informed that preparation of this database is in process.

- We found one case where we were unable to select a sample for an agent's disbursements due to the lack of organization in his cleared disbursement vouchers (\$1,033,684).

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6.2.16 For our sample of RRRP disbursements tested we found that all key internal controls for the funding approvals to which disbursements related were followed, except for the following deviations:

- We found one case where the Allocation of Funds document did not specify the source of funding (\$18,000,000).
- We were not provided with 13 of 36 signed letters of appointment for Disbursing Agents.
- We found one case where the remaining funds returned by the agent did not match the accounting database (\$35,294).
- We found one case where a Disbursing Agent left Iraq without clearing his advance (\$1,400,000). We were informed by the CPA Comptroller that supporting documentation was believed to be in Iraq. The CPA Comptroller's Office is in process of obtaining the documentation.

6.2.17 For our sample of RRRP disbursements tested we found that all key internal controls for the bidding on and awarding of contracts to which disbursements related were followed, except for the following deviations:

- We found 155 cases where supporting documentation for the bidding on and awarding of contracts were available at the CPA Comptroller's Office in Baghdad. We were informed by the CPA that supporting documentation for the remaining 311 cases should be available in CPA Regional Offices in accordance with PRB Guidance.
- We found 12 cases where contracts were not signed by suppliers (\$6,452,570).
- We found 111 cases where contracts were not on file for payments made (\$13,445,965).

6.2.18 For our sample of RRRP disbursements tested we found that purchase invoices were signed and approved by an authorized person in accordance with the PRB Guidance and Funding Guidance issued by the CPA Comptroller, except for the following deviations:

- We found one case where a Disbursing Agent returned supporting documentation in excess of funds advanced to him (\$10,900,000). Of this amount, we found eight cases where advances to Pay Agents from the Disbursing Agent were incorrectly recorded as contractor payments rather than advances to Pay Agents (\$3,237,872) and one case where the supporting documentation for a disbursement was recorded twice (\$369,000). We were informed by the CPA Comptroller that this issue is under investigation by the CPA Inspector General.
- We found a second case where a Disbursing Agent returned supporting documentation in excess of funds advanced to him (\$3,596,650). Of this amount, we found nine cases

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where advances to Pay Agents from the Disbursing Agent were incorrectly recorded as contractor payments rather than advances to Pay Agents (\$ (\$3,437,500)). We were informed by the CPA Comptroller that this issue is under investigation by the CPA Inspector General.

- We found 40 cases where we were unable to obtain any supporting documentation for payments (\$178,500). We also found 25 cases where the nature of a payment was unclear due to incomplete supporting documentation (\$8,567,481). In addition, we found 108 cases where we were unable to obtain purchase invoices for payments made (\$22,998,842).
- We found one case where payment was made in full before the contract was signed (\$500,000).
- We found two cases where purchase invoices from suppliers were of a lower value than payments made (\$53,000 difference).
- We were informed by the CPA Comptroller that there was an ongoing investigation on \$100,000 of unsupported disbursements of one Disbursing Agent. We are unaware of the outcome of this investigation.

6.2.19 For our sample of RRRP disbursements tested we found adequate supporting documentation for goods received or evidencing services rendered, except for the following deviations:

- We found 111 cases where we were unable to obtain receiving reports or other supporting documentation evidencing services received, for payments made (\$19,647,865).

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Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the disbursements for the period from 1 January 2004 to 28 June 2004. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We have performed an examination of the statement of cash receipts and payments of the Development Fund for Iraq for the period from 1 January 2004 to 28 June 2004, with our audit report issued thereon on 30 September 2004. We expressed a qualified audit opinion on the completeness of cash receipts. We further expressed a qualified audit opinion on the completeness of export sales of petroleum and petroleum products.

This report is intended solely for the information and use of the International Advisory and Monitoring Board of the Development Fund for Iraq and the Project and Contracting Office and is not intended to be, and should not be, used by, or relied upon by, anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited. We do not accept or assume responsibility for any other purpose or to any other person to whom this statement is shown or into whose hands it may come save where expressly agreed by our consent in writing.

Manama, Kingdom of Bahrain
30 September 2004

KPMG

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Appendix
Procedures

To assist the IAMB and the CPA in determining whether the disbursement of resources from the DFI is in accordance with the provision of United Nations Security Council Resolution 1483 paragraph 14 and that DFI funds are used in transparent manner and for the purposes for which they were disbursed, you have requested us to perform the following procedures for the period from 1 January 2004 to 28 June 2004:

1. Document the key internal controls at the CPA over the disbursement of resources to the Iraqi Ministries and list any deficiencies in those controls. Iraqi Ministries consist of Ministries and other governmental organizations responsible for implementing programs for which disbursements from the DFI are made.
2. For all disbursements to Iraqi Ministries, observe funds disbursed by the DFI were properly authorized, in accordance with the CPA's policies and procedures, and that there was documentation of receipt of such disbursements by each Iraqi Ministry.
3. Document the key internal controls over the monitoring process implemented by the CPA on disbursement of resources made by the Iraqi Ministries and list any deficiencies in those controls.
4. Visit management and Inspector Generals of the Iraqi Ministries to document the key internal controls at the Iraqi Ministries (as established by the CPA and the Iraqi Ministries) designed to ensure that disbursement of resources from the DFI are utilized as intended and list any deficiencies in those controls.
5. For a sample (scope to be determined at a future stage) of disbursements for the visited Iraqi Ministries' own disbursement transactions, perform the following work:
 - Compare payroll details for each employee to the accounting records and personnel file,
 - Determine whether the key internal controls, for approving, bidding and awarding of contracts to which disbursements related to were being followed;
 - Observe whether contracts and purchase invoices are signed and approved by an authorized person in accordance with the CPA's and the Iraqi Ministries' policies and procedures,
 - Compare expenditure to goods received notes or other supporting documentation evidencing services received.

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For a sample (scope: to be determined at a future stage) of disbursements made on behalf of the Iraqi Ministries, perform the following work:

- Determine whether the key internal controls, for approving, bidding and awarding of contracts to which disbursements related to were being followed;
- Observe that contracts and purchase invoices are signed and approved by an authorized person in accordance with the CPA's and the Iraqi Ministries' policies and procedures,
- Compare expenditures to goods received notes or supporting documentation evidencing services received.