

**Development Fund for Iraq**

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

**For the period from 1 January 2005 to 30 June 2005**

KPMG Iraq

29 September 2005

*This report contains 22 pages*



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**Report of Factual Findings**  
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To the Government of Iraq  
To the International Advisory and Monitoring Board of  
the Development Fund for Iraq

We have performed the procedures enumerated in the attached Appendix A, which were agreed with the Government of Iraq and the International Advisory and Monitoring Board of the Development Fund for Iraq, 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 2005 to 30 June 2005. The Government of Iraq 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*.

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 Appendix A, 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 Iraqi Ministries over disbursements of DFI funds**

**1.1 Procedure**

We documented the key internal controls implemented by the Iraqi Ministries designed to ensure that disbursements from the Development Fund for Iraq (DFI or the Fund) are utilized as intended. Iraqi Ministries consist of Ministries and other Iraqi governmental organizations responsible for implementing programs for which disbursements from the DFI are made.

**Key internal controls**

*Controls over disbursements from the DFI*

- 1.1.1 The 2005 Iraqi budget was prepared using systems, forms and formats historically used in Iraqi budgets and prepared by each Iraqi Ministry. The proposed budget was reviewed by appropriate officials from the Ministry of Finance (MoF) and Ministry of Planning, and approved by the Government of Iraq during February 2005.
- 1.1.2 The 2005 Iraqi budget was issued to the Iraqi Ministries during April 2005.
- 1.1.3 Subsequent to the dissolution of the Coalition Provisional Authority (CPA) on 28 June 2004, authority over the DFI was transferred to the Government of Iraq.
- 1.1.4 The Central Bank of Iraq (CBI) has signatory authority over the DFI accounts at the US Federal Reserve Bank of New York (FRBNY) and is required to make payments only on written instruction by the MoF.
- 1.1.5 Transfers of DFI funds to the MoF are to be made in accordance with fund request letters, authorized by both the Prime Minister and the Minister of Finance. Fund request letters are to be based on projected cash requirements for all Iraqi Ministries for the following month, as prepared by the MoF.
- 1.1.6 The Iraqi banking system does not have the capability to execute wire transfers for irrevocable documentary letters of credit (LCs) to international suppliers. Accordingly, international payments are to be made by the DFI on behalf of the Iraqi Ministries, and charged against their budgets. All international payments are subject to approval by the MoF.
- 1.1.7 Disbursements for LCs are required to be facilitated by the Trade Bank of Iraq (TBI) and arranged by JP Morgan Bank.

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1.1.8 In accordance with instructions issued by the MoF on 15 June 2004, a DFI sub-account was established at the FRBNY, to be managed by US Agencies (including the Project and Contracting Office, the Iraqi Reconstruction and Management Office, the Joint Contracting Command - Iraq, the JASG Comptroller, the DFI Disbursing Office, the Defense Contract Management Agency, the US Army Corps of Engineers and Coalition Forces) and to be monitored by the MoF, to facilitate disbursements for contracts signed by the former CPA, requiring payment subsequent to 28 June 2004.

Existing contracts and subsequent contract modifications were to be approved by the respective line Ministry. Disbursements for contracts administered by US Agencies were to be paid by the CBI, subject to prior approval by the MoF.

*Controls over disbursements from the Iraqi Ministries*

1.1.9 The MoF is responsible for distributing DFI funds to Iraqi Ministries and Provincial Treasuries on a monthly basis, in accordance with their cash requirements for the following month. Additional funding requirements are to be subject to authorization by the MoF Budget Department.

1.1.10 On a monthly basis, Iraqi Ministries and Provincial Treasuries are required to prepare a trial balance, revenue and disbursement reports, a projects and services report, and bank reconciliations. These reports are to be submitted to the MoF Consolidation Department for review and consolidation.

1.1.11 Contracts for goods and services require different levels of authorization according to value. For contracts in excess of Iraqi Dinars 5,000,000 (\$3,425) a tender process is to be undertaken, whereby a minimum of three bids are to be obtained and the successful bidder is to be approved by an Award Committee and authorized by the Head of Division. A public tender is required for contracts in excess of Iraqi Dinars 50,000,000 (\$34,250).

1.1.12 Tender Opening, Technical and Financial Committees are to be appointed, for public tenders, by the relevant Ministry. Individuals may not be appointed to more than one of these Committees. The successful bidder is to be approved by the Head of Division, Deputy Minister or Minister, depending on the value of the contract.

1.1.13 An Executive Ministers' Committee, headed by Dr. Ahmed Jalabi, Deputy Prime Minister, was appointed in April 2005 to review and approve contracts greater than \$3,000,000, for all Iraqi Ministries.

1.1.14 Letters of guarantee (LGs) are to be obtained from Ministry contractors, to ensure that in the event of non-performance, the Ministry can recover administration costs and impose a penalty fee.

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- 1.1.15 Final disbursements to contractors are to be made only after goods are received or services rendered in full, and approved by the relevant Ministry.
- 1.1.16 Individual Iraqi Ministries and Provincial Treasuries (15) are to be subject to audits by the audit function of the MoF (over 60 auditors) and the BSA (over 800 auditors).

**Findings**

- 1.1.17 Refer to sections 2 and 3 for key internal controls tested and findings.

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## 2 Disbursements from the DFI

### 2.1 Procedure

We visited the MoF, four Iraqi Ministries (Oil, Trade, Electricity and Construction & Housing) and the Kurdish Regional Government (KRG) and compared amounts transferred from the DFI to the MoF, and subsequently from the MoF to the Iraqi Ministries' and the KRG's accounting records. We were denied access to the Ministry of National Security & Defense. We did not perform procedures at the Ministry of Interior due to security issues. The Iraqi Ministries at which we performed procedures were selected by the Ministry of Finance.

#### Findings

##### *Transfers from the DFI to the MoF*

2.1.1 We found that DFI funds were disbursed to the MoF, in accordance with fund request letters, and signed by the Prime Minister and the Minister of Finance. We also found that the fund request letters were based on the cash requirements of the Iraqi Ministries as projected by the MoF for the following month.

2.1.2 Payments from the DFI, made directly and indirectly, to the MoF for the period from 1 January 2005 to 30 June 2005, were as follows:

<i>MoF</i>	
April	\$ 451,257,953
May	1,497,600,000
June	502,400,000
 <i>CBI treasury</i>	
January	1,200,000,000
February	2,000,000,000
April	400,000,000
May	800,000,000
June	<u>150,000,000</u>
	<u>\$ 7,001,257,953</u>

We found that DFI payments were made to a CBI US Dollar account at the FRBNY, reimbursing advances of \$4,550,000,000 made by the CBI to the MoF on behalf of the DFI during the period from 1 January 2005 to 30 June 2005.

At the request of the MoF, the DFI account held at the CBI was closed in April 2005 and the remaining balance of \$451,257,953 was transferred to the MoF.

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2.1.3 We found that cash receipts per MoF accounting records for the period from 1 January 2005 to 30 June 2005, were as follows:

January	\$ 1,900,000,000
February	1,000,000,000
March	400,000,000
April	451,257,953
May	1,100,000,000
June	<u>1,750,000,000</u>
	<u>\$ 6,601,257,953</u>

As noted in our Report of Factual Findings in connection with Disbursements for the period to 31 December 2004, the 2004 MoF cash receipts included \$500,000,000 received from the CBI treasury in December 2004, which was reimbursed from the DFI to the CBI account at the FRBNY in January 2005. Additionally, we found that during the period from 1 January 2005 to 30 June 2005, the MoF received from the CBI treasury \$100,000,000 in excess of payments made from the DFI to the CBI treasury. Furthermore, we found that during the period from 1 January 2005 to 30 June 2005, the CBI treasury funded \$450,000,000, on behalf of the DFI, for fuel imports into Iraq.

We also agreed these disbursements to bank statements of the MoF Iraqi Dinar and US Dollar accounts and to CBI bank records.

*Transfers from the MoF to the Iraqi Ministries*

2.1.4 We noted a Cash Management Department was established in February 2005 to improve internal controls over the DFI. We were informed by the MoF that due to the achievements of the Cash Management Department, the department's head was appointed Director General of the MoF Accounting Department in June 2005. We noted that subsequent to this appointment, application of internal controls improved, the duration of the Accounting Department's monthly reporting cycle reduced to approximately two months and that the current cash position of each Iraqi Ministry is obtained and reviewed by the MoF before each funding approval is granted.

2.1.5 We found that the MoF is introducing stand-alone computers with Excel spreadsheets, and daily reports highlighting major variations between budgeted and actual funding for all Iraqi Ministries.

2.1.6 We found that DFI funds received by the MoF were distributed to other Iraqi Ministries in accordance with their monthly cash requirements.

2.1.7 We found that reconciliations between amounts transferred from the MoF and amounts received by the Iraqi Ministries visited were prepared by the MoF. We were informed that the MoF Consolidation Department investigates unreconciled items and accounting errors.

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- 2.1.8 We agreed cash transfers from the MoF to the Iraqi Ministries visited, except for the MoE. We were denied access to the relevant MoE accounting records.

*Disbursements from the DFI for letters of credit*

- 2.1.9 We were informed by the MoF that the Iraqi banking system does not have the capability to execute wire transfers for LCs to international suppliers.
- 2.1.10 We noted over 400 LCs amounting to \$1,621,174,122 net of funds returned, were paid through the authorized LC agent, JP Morgan Bank during the period from 1 January 2005 to 30 June 2005. An additional \$870,000,000 of LC funding for fuel imports is analyzed in point 3.1.2.

We visited the TBI and compared a sample of opened LCs amounting to \$1,401,289,698 to MoF funding authorizations and LC applications. We found that signed contracts, payments, invoices and other related documents for JP Morgan LCs had been appropriately documented, without exception.

- 2.1.11 In our Report of Factual Findings in connection with Disbursements for the period to 31 December 2004, we noted that LCs had been opened with three Lebanese banks. During the period from 1 January 2005 to 30 June 2005, we noted that no additional funds were deposited for LCs at these banks.

*Kurdish Regional Government*

- 2.1.12 We visited the KRG in Erbil (Ministry of Municipalities, Ministry of Construction and Housing, Ministry of Interior, Ministry of Health and Ministry of Electricity), Sulymaniyah (Ministry of Municipalities and Ministry of Construction and Housing) and Dahouk (Ministry of Municipalities).
- 2.1.13 In our Report of Factual Findings in connection with Disbursements for the period to 31 December 2004, we noted that the KRG was primarily funded by the MoF. In addition, we noted that the former CPA made direct disbursements to the KRG, including \$1,400,000,000 in June 2004.

During our visit to the KRG, we performed a cash count of the cash transferred by the former CPA and still held by the Erbil and Sulymaniyah Administrations, \$746,680,000 and \$602,000,000 respectively, totalling \$1,366,680,000. We did not count \$33,320,000, transferred from Erbil to Sulymaniyah subsequent to 30 June 2005, due to the cash being held in a separate location. We were informed by the Regional Ministries of Finance that funds will only be disbursed when projects are approved by both Regional Administrations.

- 2.1.14 We reconciled the cash transferred from the MoF during the period from 1 January 2005 to 30 June 2005, to accounting records at the Erbil and Sulymaniyah Ministry of Finance.



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### **3 Disbursements by the Iraqi Ministries**

3.1.1 We performed procedures on contract files at four Iraqi Ministries (Oil, Electricity, Trade and Construction & Housing) and at Erbil and Sulymaniyah in the KRG. We were denied access to the Ministry of National Security & Defense. We did not perform procedures at the Ministry of Interior due to security issues.

Samples were selected based on contracts with the largest disbursements (payments made either directly to the supplier or to fund LCs) during the period from 1 January 2005 to 30 June 2005.

3.1.2 At the Ministry of Oil (MoO), the sample consisted of seven contracts at the headquarters and a division (\$201,842,387). The scope and findings for oil contracts administered by US Agencies are included in Section 4.

During the period from 1 January 2005 to 30 June 2005, \$1,370,000,000 was transferred to JP Morgan Bank for the procurement of light petroleum products for import, due to a shortage of Iraqi refining capacity. Of this amount, \$870,000,000 was funded directly from the DFI, \$450,000,000 was funded by the CBI treasury on behalf of the DFI and \$50,000,000 was funded directly from the MoF. We tested 32 disbursements (\$241,568,876) made by the State Oil Marketing Organization (SOMO), the sales arm of the Ministry of Oil, for imports during 2005.

3.1.3 At the Ministry of Electricity (MoE), the sample consisted of 15 contracts at the headquarters (\$159,818,136). The scope and findings for electricity contracts administered by US Agencies are included in Section 4.

3.1.4 At the Ministry of Trade (MoT), the sample consisted of 21 contracts at one division (\$420,151,945).

3.1.5 At the Ministry of Construction and Housing (MoCH), the sample consisted of 10 contracts at the headquarters and two divisions (\$133,493,593).

3.1.6 At the Erbil Regional Government, the sample consisted of 14 contracts (\$382,297,546), including three contracts located in Dahouk that were funded by the Erbil MoF (\$10,286,320).

3.1.7 At the Sulymaniyah Regional Government, the sample consisted of seven contracts (\$69,210,208).

3.1.8 Our findings noted in this report have been agreed with relevant officials at the Iraqi Ministries visited, except for the State Company for Oil Projects (a division of the MoO) and the State Company for Foodstuff Trading (a division of the MoT). Copies of our findings were provided to these divisions, however despite numerous requests, we did not receive written comments.

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**3.2 Procedures and findings**

For the sample of contract disbursements we found that all key internal controls for approving, bidding on, and awarding of, contracts to which disbursements related were followed, except for the following exceptions:

*Ministry of Oil*

- 3.2.1 We found two cases where non-refundable fees (\$10,000 and \$20,000) were charged to obtain tender documents (total contract value \$150,302,897).
- 3.2.2 We found six cases where the Technical Committee also acted as the Opening Committee (\$154,939,157).
- 3.2.3 We found one case where the contract signed in 2004 (\$135,911,176) included a clause which stated that 7% of the contract value was to be used at the discretion of the MoO for spare parts, supervisory personnel, or other needs as considered necessary. We requested, but were not provided with, further information for this contractual clause.
- 3.2.4 During our procedures at SOMO over the import of light petroleum products (payments of \$1,370,000,000), we agreed a sample, without exception, disbursements to supporting documentation including contracts, invoices, shipping documents and requests for payment.

We found that during January 2005, SOMO commenced payment of demurrage claims for imports of light petroleum products. Total amount of demurrage claims as calculated by SOMO, for the period from 1 January 2005 to 30 June 2005, was \$5,897,746.

*Ministry of Electricity (MoE)*

- 3.2.5 We found three cases where LCs were opened on the basis of purchase orders rather than signed contracts (\$2,659,100). We noted that the purchase orders included complete supplier and Ministry details, and was signed by both. We found that evidence supporting delivery of goods was not documented on the contract file.
- 3.2.6 We found 14 cases where we were not provided with bidding and awarding documentation for contracts (\$159,260,740).

Of these cases, one contract was awarded through an invitation to bid made to a single contractor (\$15,308,980). The contract included a clause allocating \$600,000 for "Iraqi employees". We requested, but were not provided with, additional information regarding this contractual clause.

We additionally found that of these cases, one contract signed after April 2005 was not approved by the Executive Ministers' Committee (contract value \$64,000,000).

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3.2.7 We found three cases where the successful bidder was required to pay a ‘tender fee’ of 0.1% of the contract value, subsequent to the signing of the contract (total contract value \$4,779,358). We requested, but were not provided with, additional information regarding the collection of these fees.

3.2.8 We found eight cases where LGs were to be provided by contractors, but evidence that they were obtained was not documented on the contract file (contract value \$26,822,839). We additionally found four cases where contracts did not include a clause requiring an LG to be provided (\$4,933,318).

*Ministry of Trade*

3.2.9 We found one case where we were not provided with bidding and awarding documentation for a contract (\$18,165,000).

3.2.10 We found two cases where direct invitations to bid were made to contractors instead of a public tender (\$18,600,000).

3.2.11 We found one case where we were not provided with the justification of contract award (\$6,888,000).

3.2.12 We found six cases where LGs were to be provided by contractors, but evidence that LGs were obtained was not documented on the contract file (total contract value \$95,478,000).

*Ministry of Construction & Housing*

3.2.13 We found two cases where we were not provided with bidding and awarding documentation for contracts (\$9,524,567). We were informed that one of these contracts was signed during 2002 and that the bidding and awarding documents were destroyed during the hostilities (\$3,154,567).

3.2.14 We found three cases where contracts were awarded directly to MoCH divisions. Bidding and awarding procedures were not applied to these awards as the work was performed directly by the Ministry’s divisions (\$41,986,667).

*Erbil and Dahouk*

3.2.15 We found one case where a contract issued on an ‘indefinite delivery, indefinite quantity’ basis did not specify a maximum contract amount (disbursements of \$689,633 during the current period).

3.2.16 We found one case where a non-refundable fee (\$2,500) was charged to participate in the tender (contract value \$9,186,557).

3.2.17 We found one case where direct invitations to bid were made to three contractors instead of a public tender (\$17,500,000).

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- 3.2.18 We found eight cases where contracts were awarded on a sole source basis and the award justified by a project committee (seven totaling \$312,971,989 and one of unspecified value, see 3.2.15).

Of these contracts, we found four cases where contract files contained insufficient documentation to verify that the contract price was fair and reasonable (\$234,710,260). Additionally, for two of these contracts, the files contained insufficient documentation to support the award on a sole source basis (\$168,217,300).

*Sulymaniyah*

- 3.2.19 We found one case where we were not provided with bidding and awarding documentation for a contract (\$4,009,075).
- 3.2.20 We found two cases where non-refundable fees (\$300 and \$1,000) were charged to participate in the tender (total contract value \$23,478,849).
- 3.2.21 We found one case where a contract was not awarded on a lowest-cost basis. Justification of the award was not documented in the contract file (\$24,000,000).

**3.3 Procedures and findings**

For the sample of contract disbursements we observed that purchase invoices were signed and approved by an authorized person in accordance with the Iraqi Ministries' policies and procedures, except for the following exceptions:

*Ministry of Oil*

- 3.3.1 No exceptions noted.

*Ministry of Electricity*

- 3.3.2 We found 12 cases where evidence of contractual performance was not documented on the contract files (eight contracts were signed in 2004: \$74,370,681 and four in 2005: \$3,216,496). The contract files did not contain invoices, goods received notes or monitoring reports.

*Ministry of Trade*

- 3.3.3 No exceptions noted.

*Ministry of Construction and Housing*

- 3.3.4 No exceptions noted.

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*Erbil and Dahouk*

- 3.3.5 No exceptions noted.

*Sulymaniyah*

- 3.3.6 We found two cases where advance payments (\$2,900,000) were made to contractors without an advance payment clause being included in the original contract (total contract value \$36,800,000).

**3.4 Procedures and findings**

For the sample of contract disbursements we observed the adequacy of supporting documentation for goods received or evidencing services rendered, except for the following exceptions:

*Ministry of Oil*

- 3.4.1 No exceptions noted.

*Ministry of Electricity*

- 3.4.2 We found one case where the origin of goods had been changed subsequent to the contract award (\$557,396).

- 3.4.3 We found one case where evidence of goods received and services rendered was not documented in the contract file (\$3,881,202).

*Ministry of Trade*

- 3.4.4 We found two cases where goods received per goods received notes did not agree to goods received per the Accounting Department's records by 4,248 tons of a total of 17,500 tons delivered (milk, total contract value \$54,355,000).
- 3.4.5 We found one case where payment was made for goods described in a quality control report as being of quality unfit for human consumption (220 tons of tea, approximate value \$286,968). We additionally noted that 640 tons of tea received was of a lower quality than that specified in the contract. We were informed that the tea was purchased at a discount. Furthermore, we noted that documentation retained on the contract file for 1,140 tons of tea purchased was incomplete.

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*Ministry of Construction & Housing*

- 3.4.6 In our Report of Factual Findings in Connection with Disbursements for the period to 31 December 2004, we noted one case where cranes were delivered to the Iraqi border in accordance with contract terms. We were informed that due to security constraints, the goods had not been transported into Iraq (\$1,483,500). During our current procedures, we noted that according to documentation retained on the contract file, the cranes had been delivered to Iraq.

*Erbil and Dahouk*

- 3.4.7 No exceptions noted.

*Sulymaniyah*

- 3.4.8 No exceptions noted.

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## **4 Disbursements for contracts administered by the US Agencies**

### **4.1 Background**

- 4.1.1 Following the dissolution of the CPA on 28 June 2004, authority and control of the DFI accounts was transferred to the Government of Iraq. During the period from 22 May 2003 to 28 June 2004, the CPA signed contracts, some requiring payment after 28 June 2004.
- 4.1.2 In accordance with a memorandum issued by the MoF (the MoF Memorandum) on 15 June 2004, a DFI sub-account was established at the FRBNY, to be managed by the US Agencies and to be monitored by the MoF, to facilitate disbursements for contracts signed by the former CPA, requiring payment subsequent to 28 June 2004. US Agencies estimate contractual commitments for these contracts as at 30 June 2005 to be \$870,080,621 (31 December 2004: \$1,386,180,827).
- 4.1.3 During the period from 29 June 2004 to 31 December 2004, \$2,800,000,000 was deposited into the DFI sub-account by the Government of Iraq to fund these contracts (period from 1 January 2005 to 30 June 2005: no additional payments).
- 4.1.4 In accordance with the MoF Memorandum, contracts administered by the Project and Contracting Office (PCO) were to be in accordance with CPA Memorandum 4, *Contract and Grant Procedures*. Furthermore, contracts were not to be terminated or modified unless authorized by the Government of Iraq and additional contracts were not to be signed without authorization by the Government of Iraq.
- 4.1.5 The authority for the US Agencies to administer these contracts, as stated in the MoF Memorandum, expires on 31 December 2005, where contract administration will be transferred to the Government of Iraq.
- 4.1.6 With the contract administration set to expire on 31 December 2005, US Agencies have established a committee to manage the transition of information and documents from US Agencies to the Government of Iraq. We were informed that certain legal matters regarding the physical 'hand-over' of documents from US Agencies to the Government of Iraq need to be resolved.
- 4.1.7 On 18 April 2005, a US Agency, the Joint Contracting Command – Iraq (JCC-I), was appointed to be responsible for administration of the DFI sub-account.
- 4.1.8 The JCC-I is in the process of updating all DFI-funded contract files (with regard to receipt of goods, services rendered, and vendors paid) to ensure that all DFI funded contracts have been completed and properly documented. JCC-I expects that all contract files will be updated before 31 December 2005.

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4.1.9 Payments processed by the DFI Disbursing Office for the period from 1 January 2005 to 30 June 2005 are as follows:

<i>Ministry of:</i>	<i>Contracts</i>	
National Security and Defense	Weapons & equipment	\$ 201,965,108
Oil	Restoration of oil infrastructure	35,506,766
Oil	Emergency pipeline repair	1,817,168
Electricity	Reconstruction of power plants	23,588,925
Finance	OFF: Northern program	863,493
Finance	OFF: Audit	346,700
Agriculture	OFF: Equipment	2,343,517
Various ministries	10 programs	2,779,515
Various ministries	CERP	629,113
Various ministries	RRRP	32,605,424
		<u>\$ 302,445,729</u>

The sample consisted of ten funding plans (programs), which included 78% of disbursements by value for the period from 1 January 2005 to 30 June 2005.

**4.2 Procedure and findings**

For the sample of contract disbursements we found that all key controls for funding approvals to which disbursements related were followed, except for the following exceptions:

We found eight cases where there was no formal approval of funding for contracts and task orders (total contract value of \$99,617,536).

**4.3 Procedures and findings**

For the sample of contract 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 exceptions:

4.3.1 We noted that payments to the US Army Corps of Engineers (USACE) were authorized by the former CPA, through a series of Memoranda of Understanding (MoU). Under these MoU, the USACE utilized DFI funds for contracts approved by the CPA Administrator and administration charges relating to these contracts.

We found four cases where direct disbursements and advance payments were made to the USACE for the restoration of oil infrastructure (\$35,506,766) and restoration of Iraqi electricity (\$10,000,000), and one return payment of \$1,500,000.



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We noted that the oil infrastructure payments were made to the USACE on the basis of the MoU and payment orders signed by the DFI Comptroller, the Contracting Officer and the Defense Contract Audit Agency, rather than on the basis of a contract, valid task order, an invoice and a goods received note. We additionally noted that the electricity restoration payment was made on the basis of Memoranda approved by US Agencies and the Government of Iraq. We received confirmation from the USACE of DFI amounts received during the current period.

In 2004, a USACE contract was funded by the DFI (\$5,687,960). The contract funding was subsequently changed from DFI to other sources. We were informed that this amount will be returned to the DFI. As at the date of this report, the USACE had not refunded this amount to the DFI.

- 4.3.2 We found ten cases where contracts were administered using US Federal Acquisition Regulations (FAR) as opposed to CPA Memorandum 4 regulations (\$192,022,764). These contracts were awarded and administered in the United States. We were informed by the JCC-I that the FAR are considered to be more comprehensive contracting regulations.
- 4.3.3 We found two cases where deadlines for completion were passed without documentation to support the reasons for the delay, or to establish a subsequent deadline. In one case, a penalty of \$492,000 could have been charged to the contractor for late delivery of goods. The penalty clause was not enforced and written justification for non-enforcement was not documented in the contract file (total contract value \$28,143,108).
- 4.3.4 We found three cases where contractors were overpaid due to invoices being paid twice (overpayments of \$3,484,014). The overpayments were refunded to the DFI or subsequent payment orders adjusted.
- 4.3.5 We found six cases where contracts (total contract value of \$93,074,335) were modified after 28 June 2004, without authorization as required by the relevant Iraqi ministries. Of these, five cases resulted in a decrease of the contract values by a total of \$4,424,980. The other case resulted in changes to the service performed and the project's location.
- 4.3.6 We found one case where we were not provided with complete bidding or awarding documentation as required by CPA Memorandum 4. As a result we were unable to determine whether the contract was awarded on a competitive basis (original contract value \$2,500,000).

This contract was signed in July 2004, subsequent to the transfer of authority to the Government of Iraq. The contract was modified in September 2004 (\$8,347,390). The total contract value was approved by the Ministry of Finance along with 15 other contracts, as noted in 4.3.7 below.

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4.3.7 In our Report of Factual Findings in Connection with Disbursements for the period to 31 December 2004, we noted that 23 contracts with a total value of \$86,695,206 had been identified as signed or modified after 28 June 2004, although the contracts and modifications were not signed by authorized parties. During April 2005, 16 of these contracts with a total contract value of \$82,709,705 were approved by the Minister of Finance. We were informed that the remaining contracts were cancelled or were funded from alternative sources.

4.3.8 In our Report of Factual Findings in Connection with Disbursements for the period to 31 December 2004, we found six cases where contracting files could not be located. During our procedures for the current period, we were provided with two of these missing contracts and noted that one of these contracts did not contain evidence of monitoring in the contract file.

**4.4 Procedures and findings**

For the sample of contract disbursements we found that purchase invoices were signed and approved by an authorized person in accordance with CPA Memorandum 4, except for the following exceptions:

4.4.1 We found 13 cases where purchase invoices were not on file (\$25,095,016).

**4.5 Procedures and findings**

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

4.5.1 We found one case where documentation retained on the contract file was not organized. As a result, we are unable to ascertain whether adequate supporting documentation was on file (disbursements of \$12,064,347).

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**4.6 Contractual commitments**

4.6.1 During the course of our procedures we found a number of inaccuracies in the database of outstanding contractual commitments for DFI sub-account funded contracts.

**Findings**

4.6.2 The database of contractual commitments is summarized as follows:

<i>Description:</i>	<i>Number of Contracts:</i>	<i>Commitment</i>
Open contracts with outstanding commitments	618	\$ 355,885,769
Closed contracts with outstanding commitments	1,112	567,049,120
Open contracts with overpayments	79	(38,017,911)
Closed contracts with overpayments	<u>173</u>	<u>(14,836,357)</u>
	<u>1,982</u>	<u>\$ 870,080,621</u>

4.6.3 We vouched a sample of 17 open contracts with outstanding commitments per the database of \$216,744,800 to contract files. We found that outstanding commitments were overstated by \$128,104,088.

4.6.4 We vouched a sample of 11 closed contracts with outstanding commitments per the database of \$389,887,833 to contract files. We found that there were no outstanding commitments for these closed contracts.

4.6.5 We vouched a sample of six open and closed contracts with overpayments per the database of \$44,324,578 to contract files. We found overpayments of \$1,426,060 for two closed contracts and no outstanding commitments for the remaining overpayments of \$42,898,518.

4.6.6 During our agreed-upon procedures on disbursements we found 17 cases where outstanding contractual commitments for contracts of \$80,508,489 were not included in the database.

4.6.7 During our agreed-upon procedures on disbursements we were informed by USACE of outstanding contractual commitments under Memoranda of Understanding of \$180,789,505 for fuel imports and oil infrastructure construction projects. We found that the database did not include any commitments to the USACE for this amount. JCC-I were unaware of these outstanding commitments and they are currently investigating this matter.

4.6.8 We were informed by JCC-I that they are in the process of reviewing the database of outstanding contractual commitments and expect to complete their procedures prior to 31 December 2005. We were further informed that the DFI accounting database will not be reconciled with the contracting database.

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**4.7 Commander's Emergency Response Program (CERP)**

We performed procedures on CERP program with two funding sources, DFI funding (DFI CERP) and funding received post-28 June 2004 from the Government of Iraq (IIG CERP).

**Procedures and findings**

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

*DFI CERP*

- 4.7.1 During the period from inception to 30 June 2005, \$356,876,724 was disbursed for DFI CERP programs. We have tested 24% of DFI CERP disbursements since inception, of which 3% were tested during the current period. For the sample of 26 disbursements, we requested contract files.
- 4.7.2 As noted in our Report of Factual Findings in connection with Disbursements for the period to 31 December 2004, a database of DFI CERP disbursements is no longer maintained by Coalition Forces.
- 4.7.3 We found one case where we were unable to obtain either a purchase invoice or a payment voucher for the disbursement (\$68,010).
- 4.7.4 We found ten cases where we were unable to obtain evidence that three bids were obtained or justification for award contract on a non-competitive basis was documented for contracts in excess of \$10,000 (total contract value of \$3,631,200).
- 4.7.5 We found one case where the contract was not located in the contract file (total disbursements of \$200,000).

*IIG CERP*

- 4.7.6 During the period from 29 June 2004 to 31 December 2004, \$136,000,000 was transferred by the Government of Iraq to Coalition Forces to fund the IIG CERP program. Of this amount, \$49,966,807 was disbursed during the period from 29 June 2004 to 30 June 2005. We tested 47% of IIG CERP disbursements. We requested contract files for the sample of 30 disbursements, and noted the following exceptions:
- 4.7.7 We found that a list of IIG CERP disbursements was maintained by Coalition Forces.
- 4.7.8 We found one case where a contract paid completely in advance did not contain progress reports as required by the contract (\$2,200,000).
- 4.7.9 We were not provided with four contract files (total disbursements of \$929,285).

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4.7.10 We found 11 cases where we were unable to obtain evidence that three bids were obtained or justification for award contract on a non-competitive basis was documented for contracts in excess of \$10,000 (total contract value of \$5,298,948).

4.7.11 We found two cases where contracts were not located in the contract file (total disbursements of \$636,740).

**4.8 Rapid Regional Response Program (RRRP)**

**Procedures and findings**

4.8.1 During the period from inception to 30 June 2005, \$552,824,379 was disbursed for RRRP programs. We have tested 59% of RRRP disbursements since inception, of which 12% were tested during the current period. We requested contract files for a sample of 33 disbursements.

4.8.2 As noted in our Report of Factual Findings in connection with Disbursements for the period to 31 December 2004, a database of RRRP disbursements is not maintained by US Agencies.

4.8.3 We found one case where one disbursement was accounted for twice, incorrectly reducing the Disbursing Agent's fund balance (\$61,325).

4.8.4 We found one case where disbursement did not have a payment voucher attached (\$266,280).

4.8.5 We found 16 cases where disbursements did not have invoices attached (\$2,343,282).

4.8.6 We found three cases where we were unable to obtain evidence that three bids were obtained or justification for award contract on a non-competitive basis was documented for contracts tested (total contract value of \$4,515,861).

4.8.7 We found 24 cases where disbursements did not have goods received notes attached (\$4,600,256).

4.8.8 We found 31 cases where disbursements did not have contracts attached (\$2,550,659).

4.8.9 We were not provided with contract files for 15 selected contracts (total value of disbursement \$5,089,367).

4.8.10 We were informed by the Special Inspector General Iraq Reconstruction office that there are several ongoing investigations on RRRP and CERP Disbursing Agents. We were denied access to these investigations.

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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 2005 to 30 June 2005. 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 2005 to 30 June 2005, with our audit report issued thereon on 29 September 2005. 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. Furthermore, we expressed a qualified audit opinion on the completeness and accuracy of contractual commitments as also noted in our findings in section 4.6.

This report is intended solely for the information and use of the Government of Iraq and the International Advisory and Monitoring Board of the Development Fund for Iraq, 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.

Baghdad, Iraq  
29 September 2005

K P M G

**Development Fund for Iraq  
Agreed-Upon Procedures  
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**Appendix A**

In accordance with the engagement letter issued on 16 July 2005, the procedures to be applied to the disbursement of resources are as follows:

1. Document the key internal controls at the Iraqi Ministries designed to ensure that disbursements from the DFI are utilized as intended.
2. Compare amounts transferred from the DFI to the Iraqi Ministries' accounting records and report any exceptions noted.
3. For a sample (scope: to be determined at a future stage) of disbursements for the visited Iraqi Ministries, perform the following work:
  - 3.1 Determine whether the key internal controls established by the Iraqi Ministries for approving, bidding and awarding of contracts to which disbursements related to were followed;
  - 3.2 Observe whether contracts and purchase invoices are signed and approved by an authorized person in accordance with the Iraqi Ministries' policies and procedures;
  - 3.3 Compare expenditure to goods received notes or other supporting documentation evidencing services rendered.
4. For a sample of disbursements for contracts administered by the US agencies in Baghdad utilizing DFI funds (CERP, RRRP and contracts signed prior to 29 June 2004), perform the following procedures:
  - 4.1 Determine whether the key internal controls established by the Program Contracting office (PCO) for approving, bidding and awarding of contracts to which disbursements related to were followed;
  - 4.2 Observe that contracts and purchase invoices are signed and approved by an authorized person in accordance with PCO policies and procedures;
  - 4.3 Compare expenditures to goods received notes or supporting documentation evidencing services rendered.