

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements

For the period from 29 June 2004 to 31 December 2004

KPMG Bahrain
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This report contains 24 pages



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Report of Factual Findings
in connection with Disbursements

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 paragraphs 14, for the period from 29 June 2004 to 31 December 2004. 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* 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 Appendix A, either for the purpose for which this report has been requested or for any other purpose.



Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

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 2004 Iraqi budget was prepared using systems, forms and formats historically used in Iraqi budgets and prepared by each Iraqi Ministry, in consultation with the former Coalition Provisional Authority (CPA) Senior Advisors. The proposed budget was then to be reviewed by appropriate officials from the CPA, the Ministry of Finance (MoF) and Ministry of Planning, and approved by the CPA Administrator.
- 1.1.2 The 2004 Iraqi budget was issued in October 2003 for the period from 1 January 2004 to 31 December 2004 and revised in March 2004 and June 2004.
- 1.1.3 Subsequent to the dissolution of the CPA on 28 June 2004, authority over the DFI 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.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

- 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 JASG Comptroller and 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 MoF. Disbursements for contracts administered by US Agencies were to be paid by the CBI, subject to prior approval by 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, and bank reconciliations. These reports are to be submitted to the MoF Consolidation and Decentralized Departments, 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 10,000,000 (\$6,900) 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 75,000,000 (\$51,400).
- 1.1.12 Technical and Financial Committees are to be appointed, for public tenders, by the relevant Ministry. 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 Letters of guarantee (LGs) are to be required from Ministry contractors, to ensure that in the event of non-performance, the Ministry can recover administration costs and a penalty fee.
- 1.1.14 Final disbursements to contractors are to be made only after goods are received or services rendered in full, and approved by the relevant Ministry.
- 1.1.15 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).

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

Findings

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

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

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 Iraqi Ministries' accounting records. The Iraqi Ministries visited were approved by the Ministry of Finance and based on the largest budgeted capital expenditures to perform our procedures.

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 29 June 2004 to 31 December 2004, were as follows:

| | |
|------------|-------------------------|
| <i>MoF</i> | |
| July | \$ 1,550,000,000 |
| August | 350,000,000 |
| December | 400,000,000 |
| <i>CBI</i> | |
| December | <u>4,450,000,000</u> |
| | <u>\$ 6,750,000,000</u> |

We found that the CBI payment was transferred to a new CBI US Dollar account at the FRBNY, reimbursing advances made by the CBI to the MoF on behalf of the DFI during the period from 29 June 2004 to 31 December 2004.

We were informed by the MoF that it was funded from CBI cash reserves in excess of requirements held in Iraq. In addition, shipping cash to Baghdad would have resulted in unnecessary transportation and security costs to the MoF.

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

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

2.1.3 We found that cash receipts per MoF accounting records for the period from 29 June 2004 to 31 December 2004, were as follows:

| | |
|-----------|-------------------------|
| July | \$ 1,550,000,000 |
| August | 350,000,000 |
| September | 1,250,000,000 |
| October | 850,000,000 |
| November | 2,350,000,000 |
| December | <u>900,000,000</u> |
| | <u>\$ 7,250,000,000</u> |

We found that the MoF cash receipts included \$500,000,000 received from the CBI in December 2004, reimbursed by the DFI to the CBI account at the FRBNY in January 2005.

Transfers from the MoF to the Iraqi Ministries

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

2.1.5 As at the date of this report, the MoF has provided us with a draft trial balance for the period from 1 January 2004 to 31 August 2004, and informed us that this trial balance is incomplete.

2.1.6 We found that financial information had not yet been submitted by certain Iraqi Ministries and Divisions for the period from 1 January 2004 to 31 December 2004, preventing the MoF from completing their accounting records and consolidations.

Accordingly, we were unable to reconcile amounts transferred from the MoF to the amounts received by the Iraqi Ministries.

2.1.7 We also found that the MoF has not yet finalized its accounting records for the year ended 31 December 2004, due to accounting records of DFI transactions not being maintained or integrated into the MoF ledgers.

2.1.8 We found that the 2004 Iraqi budget, as amended in June 2004, was adopted by the MoF without being officially approved or published.

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.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

- 2.1.10 We found over 600 LCs amounting to \$1,991,089,456, net of funds returned, were paid through the authorized LC agent, JP Morgan Bank during the period from 29 June 2004 to 31 December 2004.

We obtained from JP Morgan Bank a list of open LCs as at 31 December 2004. We agreed over 90% of the individual LC payments from the FRBNY to this list.

We visited the TBI and compared our sample of opened LCs amounting to \$1,196,939,783, to MoF funding authorizations and LC applications, signed contracts, payments, invoices and other related documents for JP Morgan LCs had been appropriately documented. We found no exceptions.

- 2.1.11 We found that 99 additional LCs for \$369,268,814, net of funds returned, had been opened by the Ministry of Trade (MoT) through three Lebanese banks during the period from 29 June 2004 to 31 December 2004. We were informed by the MoF that these LCs were authorized due to urgent food requirements, and further informed by the MoT that these LCs were opened due to delays caused by the existing LC issuance process. We found that in many cases delays were caused by errors in LC applications, made by either the suppliers or the Ministry of Trade, resulting in LCs being rejected by correspondent banks.

We visited the CBI and compared our sample of opened LCs amounting to \$220,440,966, to MoF funding authorizations and LC applications, signed contracts, payments, invoices and other related documents for the Lebanese LCs had been appropriately documented. We found no exceptions.

Kurdish Regional Government

- 2.1.12 We visited the KRG in Erbil and Sulymaniah.
- 2.1.13 During the period from 1 January 2004 to 28 June 2004, the KRG was primarily funded by the MoF. In addition, 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 Sulymaniah Administrations, amounting to \$798,000,000 and \$602,000,000 respectively, totalling \$1,400,000,000. We were informed by the Regional Ministries of Finance that funds will be disbursed when projects are approved by both Regional Administrations.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

2.1.14 We reconciled the cash transferred from the MoF during the period from 29 June 2004 to 31 October 2004, to accounting records at the Sulymaniah Ministry of Finance (ID 480,900,340,000). We were unable to reconcile payments made from 1 November 2004 to 31 December 2004, as the MoF were unable to provide us with disbursement reports regarding cash transferred to the Sulymaniah MoF, as at the date of this report such documents were not available.

We were not provided with access to accounting records maintained by the Erbil Ministry of Finance.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

3 Disbursements by the Iraqi Ministries

- 3.1.1 We performed procedures on contract files at four Iraqi Ministries (Oil, Trade, Electricity and Construction & Housing).
- 3.1.2 At the Ministry of Oil (MoO), our sample consisted of 11 contracts at the headquarters and one division (\$52,963,838). The scope and findings for oil contracts administered by US Agencies and related disbursements for fuel imports and oil restoration, are included in Section 4.
- 3.1.3 During the period from 29 June 2004 to 31 December 2004, \$1,150,000,000 was transferred to a Jordanian bank account controlled by the Ministry of Oil. This account was established for the procurement of light petroleum products for import, due to a shortage of Iraqi refining capacity. We tested 31% of total disbursements made from this account during 2004 and 2005.
- 3.1.4 At the Ministry of Electricity (MoE), our sample consisted of eight contracts at the headquarters (\$254,270,000). The scope and findings for electricity contracts administered by US Agencies and related disbursements are included in Section 4.
- 3.1.5 At the Ministry of Trade (MoT), our sample consisted of 25 contracts at two divisions, Foodstuffs and Grains (\$551,656,390).
- 3.1.6 At the Ministry of Construction and Housing (MoCH), our sample consisted of nine contracts at the headquarters and two divisions (\$27,079,523). We noted that the Ministry performs certain construction through its divisions.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

3.2 Procedures

For our 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:

Findings

Ministry of Oil

- 3.2.1 We found one case where a contract (\$75,887,913) was awarded on a non-competitive basis and justification was not documented in the contract file. A deposit for a LC (\$7,500,000) was made in December 2003 by the MoO, but not recorded in the MoO accounting records until December 2004. We were informed that work on this contract has not commenced, due to ongoing negotiations.

In our Report of Factual Findings in Connection with Disbursements for the period from 1 January 2004 to 28 June 2004, we noted that we were unable to obtain contract details for one disbursement made by the former CPA, to fund a Euro denominated LC, for \$70,257,520. During our current procedures, we found that this payment was for the above contract.

However, the LC payment was not recorded in the MoO accounting records. We noted that the Iraqi Ministries had not recorded payments made by the former CPA or the US Agencies in their accounting records.

- 3.2.2 We found one case where a contract file did not indicate the method of solicitation or tendering procedures to be followed. We found that four suppliers were invited to bid (\$1,252,850).
- 3.2.3 We found one contract was awarded to an Iraqi state-owned entity on a non-competitive basis without justification documented in the contract file (\$763,225).
- 3.2.4 We found one case where the supplier changed the origin of the goods delivered to the MoO without informing the Ministry of the change (contract value of \$700,680). Additionally, although the contract stated that a LG was to be issued to the MoO, a LG was not provided by the supplier.
- 3.2.5 During our procedures at SOMO over the import of light petroleum products (payments of \$1,150,000,000), we agreed, without exception, disbursements to supporting documentation including contracts, invoices, shipping documents and requests for payment.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

Ministry of Electricity

- 3.2.6 We found four cases where we were not provided with bidding and awarding documentation for contracts (\$245,185,000).
- 3.2.7 We found one case where we were not provided with justification for contract award (\$229,000,000).

Ministry of Trade

- 3.2.8 We found ten cases where we were not provided with bidding and awarding documentation for contracts (\$269,799,500).
- 3.2.9 We noted one case where the bid submitted, and the final award by the Technical Committee, contained differences in price and country of origin for goods. The contract file did not contain documented justification for the amendments (payments of \$7,477,792).
- 3.2.10 We found 16 cases in the Foodstuff Division where LGs were to be issued by contractors, but were not obtained by the MoT (value of open LCs \$374,564,170).

Ministry of Construction & Housing

- 3.2.11 We found five contracts where MoCH divisions were awarded on a non-competitive basis without documented justification in the contract file (\$55,714,220).

3.3 Procedures

For our sample of contract disbursements we observed whether purchase invoices were signed and approved by an authorized person in accordance with the Iraqi Ministries' policies and procedures.

Findings

- 3.3.1 We found no exceptions.

3.4 Procedures

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

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

Findings

Ministry of Oil

- 3.4.1 We found one case where a contract specified that payments were to be made in accordance with a completion schedule. We were not provided with the schedule and were unable to determine if payments were made in accordance with the terms of the contract (\$71,667).

Ministry of Electricity

- 3.4.2 We found one case where supporting documentation for goods received and services rendered had not been clearly documented in the contract file (\$46,716,268).

We also found that payments released under the LC for this contract were duplicated for two invoices. We were informed by the MoE that these payments were to be deducted against future invoices under the LC (duplicated payments of \$3,113,616).

- 3.4.3 We found one case where evidence of goods received and services rendered had not been documented in the contract file (\$4,996,670).

Ministry of Trade

- 3.4.4 We found that 10% of the budget for the import of grain into Iraq, as approved by the MoT, was awarded on a limited competition basis to 12 Iraqi trading companies. We noted that as at the date of this report, grain has not been delivered under these contracts (payments for open LCs of \$51,135,000).

- 3.4.5 We noted one case where goods were inspected at the port of origin, rather than at the port of delivery in Iraq. We noted that reconciliation between the quantities shipped from the port of origin and quantities delivered to an Iraqi port identified missing and damaged goods of \$792,146.

- 3.4.6 We were informed by the MoT that 47 LCs were cancelled due to non-performance by suppliers. In addition, we were not provided with evidence of accompanying LGs for these cancelled LCs (\$133,627,673).

Ministry of Construction & Housing

- 3.4.7 We found 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 have not been transported into Iraq (\$1,483,500).

- 3.4.8 We found two cases where evidence of goods received and services rendered had not been documented in the contract file (\$4,992,327).

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

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 were 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. We received a list of these contracts, although we were informed by the US Agencies that the list may be incomplete and inaccurate. As at 31 December 2004, contractual commitments were estimated by the US Agencies to be \$1,386,180,827 (28 June 2004: \$3,057,518,000).
- 4.1.2 In accordance with the 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.
- 4.1.3 The authority for the US Agencies to administer these contracts, as stated in the MoF Memorandum, expired on 31 December 2004, and was subsequently extended to 31 December 2005.
- 4.1.4 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.
- 4.1.5 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.
- 4.1.6 We were informed by the PCO that not all CPA contract files have been documented in accordance with CPA Memorandum 4 due to the urgency of reconstruction required in Iraq, lack of personnel and the high turnover of contract administrators. A US Agency has been assigned and is in the process of ensuring that all DFI-funded contracts have been completed (with regard to receipt of goods, services rendered, and vendors paid) and all DFI-funded contract files properly documented. The PCO expects that all files will be updated, and completed where appropriate, before 30 September 2005.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

4.1.7 Payments processed by the DFI Disbursing Office for the period from 29 June 2004 to 31 December 2004 are as follows:

| <i>Ministry of:</i> | <i>Contracts:</i> | |
|-------------------------------|--|-------------------------|
| Oil | Import of petroleum products | \$ 337,026,513 |
| Oil | Restoration of oil infrastructure | 83,919,421 |
| Oil | Security | 20,127,709 |
| Oil | Emergency pipeline repair | 12,207,112 |
| National Security and Defense | Weapons & equipment | 411,132,017 |
| Electricity | Restoration of Iraqi electricity | 207,560,421 |
| Electricity | Reconstruction of power plants | 37,013,452 |
| Electricity | Purchase of electricity from Turkey | 7,432,224 |
| Finance | Iraqi media network | 59,373,049 |
| Finance | OFF: Northern program | 23,872,080 |
| Finance | OFF: Audit | 18,154,180 |
| Transport | Baghdad International Airport security | 24,999,958 |
| Agriculture | Poultry production | 7,882,500 |
| Agriculture | OFF: Equipment | 5,349,184 |
| Agriculture | Fertilizer | 3,510,807 |
| Interior | Passport system | 9,153,339 |
| Planning | PMO office construction | 5,862,692 |
| Trade | OFF: Certification | 3,760,536 |
| Various ministries | 55 programs | 46,180,488 |
| Various ministries | Letters of Credit | 214,645,809 |
| Various ministries | Net payments on behalf of the Iraqi Ministries | 25,696,009 |
| Various ministries | CERP | 87,466,915 |
| Various ministries | Rapid Response Regional Program | 204,162,063 |
| | | <u>\$ 1,856,488,478</u> |

During August 2004, the MoF increased funding of the Commander's Emergency Response Program (CERP) program by \$86,000,000 from its own budget.

Our sample consisted of 47 funding plans (programs), which included 94% of disbursements by value for the period from 29 June 2004 to 31 December 2004.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

4.2 Procedure

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

Findings

- 4.2.1 We found 17 cases where there was no formal approval of funding for contracts or payments (payments of \$242,160,103).
- 4.2.2 We found three cases where funding allocations for projects had been exceeded by \$8,430,544.
- 4.2.3 We found one case where a contract was to be funded 50% by non-DFI funds and 50% from the KRG. The entire contract value was paid from DFI funds (\$1,975,864).

4.3 Procedure

For our 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 found 17 cases where direct disbursements and advance payments had been made to the USACE for import of petroleum products (\$188,957,065), restoration of oil infrastructure (\$83,919,421), restoration of Iraqi electricity (\$207,478,290) and other contracts (\$11,559,573).
- 4.3.2 We noted that payments to the USACE were authorized by the CPA, through a series of Memoranda of Understanding (MoU). Under these MoU, the USACE utilized DFI funds for contracts approved by the CPA Administrator, including administration charges.
- 4.3.3 We had limited access to contracting procedures and documentation for contracts awarded by the USACE, as follows:

For oil reconstruction and fuel import contracts, we were informed by the USACE that due to ongoing US federal investigations, we would not be provided with access to complete contract files. However, we were provided with a written justification for the sole source contract and certain task orders for oil reconstruction and fuel import. The USACE additionally informed us that other oil restoration contracts had funding sources changed from DFI to other sources.

For electricity contracts, we received written justification for limited competition. The justification was approved by the USACE during February 2003, with related task orders signed during 2003, increasing the total value of contracts to \$1,500,000,000. Three US vendors were awarded contracts from 12 bidders selected by the USACE, based on their experience outside of the US, the size of their operations and technical expertise.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

Other contracts were primarily administered by the USACE in Baghdad. We examined three contracts (\$9,618,911) and noted that one contract was awarded on a non-competitive basis (\$31,700) without documented justification on file.

We found two cases where payments were made directly to a USACE sub-contractor, without justification, rather than being made to the USACE for subsequent disbursement (\$141,894,029).

4.3.4 We noted one case where armored vehicles were purchased for US Agencies from DFI funds (disbursements of \$988,000).

4.3.5 We found four cases where bidders had less than ten days to prepare their proposals (\$94,737,686). Of these, we noted two cases (\$66,480,404) where only one bid was considered technically acceptable and two cases (\$28,257,282) where only two bids were received.

Furthermore, in one case where only two bids were received, the Contracting Officer gave three companies, including the successful bidder, advance notice prior to publicly issuing the solicitation (\$22,100,262).

4.3.6 We found one case where a contract (\$6,157,020) was advertised on a subscription only website and therefore not publicly tendered. Only two bids were received for this contract.

4.3.7 We found one case for a complex tender where justification of the award by the Contracting Officer was not in accordance with the evaluation performed by the Contract Award Committee (\$8,480,550).

4.3.8 We found one case where there were only two members of the Contract Award Committee were in attendance; CPA Memorandum 4 requires there to be three members in attendance (\$8,480,550).

4.3.9 We found one case where a contract (\$127,500) was not awarded to the lowest bidder and the basis of award was not justified. The difference between the lowest cost bidder and the successful bidder was \$60,000.

4.3.10 We found nine cases where contract files did not contain complete bidding or awarding documentation as required by CPA Memorandum 4 (\$211,729,065). In one case the contract was signed the day after the deadline for submitting proposals (\$22,100,262).

4.3.11 We found two cases where a contract was awarded on a non-competitive basis without justification (\$829,942). In one case, the Contracting Officer raised an objection to the award of the contract (\$500,000).

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

- 4.3.12 We found one case where a contract was awarded to a bidder that submitted a proposal subsequent to the meeting of the Contract Award Committee. The contract file justified the award as being due to urgent requirements, but only 50% of goods have been received in the following eight months (\$15,560,000).
- 4.3.13 We found one case where a contract (\$420,010) was signed by the Government of Iraq but administered by the PCO. The PCO was not provided with the bidding and awarding documents for the contract.
- 4.3.14 We found two cases where a contract was tendered and awarded in the US, with non-DFI funds. However, there were five task orders (\$125,172,307) on the contracts funded from the DFI. We were able to perform procedures on the task orders, but unable to determine whether the contract was awarded on a competitive basis as the original documents are in the US.
- 4.3.15 We found one case where a contract (\$95,556,100) was tendered and awarded in the US, on behalf of the US Government and with US funds, but subsequently paid using DFI funds, without being transferred to the CPA before 28 June 2004. We were unable to obtain bidding and awarding documents for the contract. The contract file contained documentation of a dispute with the contractor, as the contractor was of the opinion that the US Government was the contracting party, while the Government of Iraq believed that they were the contracting party.
- 4.3.16 We noted one case where a contract included an option for a second year of performance, although the option was not originally priced. The contractor submitted a price for the option on 27 June 2004 and the contract price increased from \$22,100,262 for the first period, to \$52,210,011 for the second period for only a 50% increase in services provided. There was no evidence on the contract file of price negotiation and incomplete documentation for the price increase; the option was signed on 28 June 2004.
- 4.3.17 We noted one case where a task order to a contract, for the assessment of security requirements at a particular location used partly by Coalition Forces, was competitively tendered and awarded to the lowest bidder (\$51,607). As a result of this assessment, the contractor was awarded a task order, on a non-competitive basis, to provide security services at the location (\$24,999,908). The price proposal for this task order was initially rejected and resubmitted by the contractor with a 20% reduction in cost.
- 4.3.18 We found two cases where contracts were signed by an Iraqi Contracting Officer (\$26,740,456). In one case the contract was signed on behalf of the US Government (\$6,157,020) and in the other case the contract did not specify the authority with which the individual entered into the contractual agreement (\$20,583,436).

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

4.3.19 We found one case where a contract (original contract value of \$49,980,737) was significantly modified in September 2004, increasing the price of the contract by \$20,583,436. The intended purpose of the DFI sub-account was to fund former CPA contracts requiring payment after 28 June 2004.

Subsequent to our findings, we were informed by US Agencies that 23 contracts with a value of \$86,695,206 have been identified as signed or modified after 28 June 2004, although these contracts and modifications were not signed by authorized parties. US Agencies expect that eight of these contracts with a total value of \$8,016,941 will be cancelled. As at the date of this report, no disbursements have been made and no services rendered or goods received. US Agencies are in the process of resolving the funding of these contracts and modifications in consultation with the MoF.

4.3.20 We also found three cases where contracts were modified after 28 June 2004, without authorization, as required by the MoF. In one case, work outside the contract scope was authorized verbally, without formal modifications being processed. In the second case, a contract was modified on 4 July 2004 to include an advance payment of \$3,000,000 and in the third case, the contract price was increased by \$4,326,923.

4.3.21 We found two cases where contracts were administered using US Federal Acquisition Regulations as opposed to CPA Memorandum 4 regulations (\$141,732,307).

4.3.22 We found three cases where contracts had been assigned to the CPA from the UN, regarding the UN Oil for Food program. We were informed by the PCO that the contract files were not administered by US Agencies, although payments of \$22,765,957 were made during the period from 29 June 2004 to 31 December 2004.

4.3.23 We found six cases where contracting files could not be located (disbursements of \$51,672,632).

4.3.24 In the Report of Factual Findings in Connection with Disbursements for the period from 1 January 2004 to 28 June 2004, we found 37 cases where contract files could not be located. During the course of our procedures for the current period we were provided with nine of these missing contracts. We noted that eight of these contract files did not contain bidding and awarding documentation.

4.4 Procedure

For our 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 ten cases where purchase invoices were not on file (\$32,922,276).

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

4.4.2 We found five cases where we were unable to obtain supporting documentation for payments (\$46,137,238).

4.4.3 We found ten cases where payments were authorized by only one individual and six cases where payment were not authorized at all (\$159,365,102). These payments were to be approved by two individuals.

4.5 Procedure

For our 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 19 cases where evidence of contract monitoring over the delivery of goods and performance of services was not documented in the contract file (\$302,102,325).

4.5.2 We found nine cases where goods received notes were not attached to payment orders (\$32,121,083).

4.5.3 We found one case where a grant (\$10,000,000) was not monitored.

4.5.4 We found one case where a contractor increased the price of their proposal by \$4,018,017 to include, in part, the accelerated delivery of equipment. Although the first delivery of equipment was three months after the due date, a payment of \$5,988,433 was made in accordance with the accelerated delivery schedule.

4.6 Commander's Emergency Response Program

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

4.6.1 For the period from inception to 31 December 2004, \$356,247,611 was disbursed for CERP programs, net of cash returns, of which \$22,362,730 is, we were informed, with Coalition Forces throughout Iraq to fund ongoing contracts. We tested 21% of CERP disbursements, of which 3% were tested during the current period.

4.6.2 In our Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004, we noted that a database of CERP disbursements was maintained by Coalition Forces. However this database was not reconciled to the CPA Comptroller's accounting records. During our procedures for the current period we found that a database of disbursements is no longer maintained by Coalition Forces, and we were informed by the DFI Disbursing Office that it will not be prepared.

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

- 4.6.3 We found that four out of six military divisions did not submit completed disbursement files to the CERP management function on a timely basis. During our procedures supporting documentation for disbursements subsequent to 31 October 2004 had not yet been submitted by the divisions.

Procedures

For our sample of CERP disbursements we found that key internal controls were followed, except for the following exceptions:

Findings

- 4.6.4 We were unable to obtain supporting documentation for disbursements by one division (\$3,095,563).
- 4.6.5 We found 42 cases where we were unable to obtain evidence that three bids were obtained or documented justification for award of contract on a non-competitive basis for contracts in excess of \$10,000 (disbursements of \$1,216,961).

We were informed by Coalition Forces that competitive bidding was not always possible in certain regions due to security constraints, difficulty in accessing local contractors and tribal matters.

- 4.6.6 We found three cases where we were unable to obtain either a purchase invoice or a payment voucher for disbursements (\$137,508).
- 4.6.7 We found four cases where we were unable to obtain either a goods received note or a payment voucher for disbursements (\$219,508).

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

4.7 Rapid Regional Response Program

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

- 4.7.1 For the period from inception to 31 December 2004, \$520,218,942 was disbursed for RRRP programs, net of cash returns, of which \$60,352,214 is, we were informed, with Disbursing Agents throughout Iraq to fund ongoing contracts. We tested 50% of RRRP disbursements, of which 34% were tested during the current period.
- 4.7.2 A Disbursing Agent returned cash relating to Seized Funds, incorrectly deposited in the DFI and repaid subsequent to 31 December 2004 to the US Agencies (\$3,098,459).
- 4.7.3 We visited two of ten regional RRRP offices (Kirkuk and Basra). For the other offices, we selected and received electronically a sample of contract files.
- 4.7.4 In our Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004 we noted that we had been informed by the DFI Disbursing Office that a central database of RRRP payments was being prepared. During our procedures for the current period, we found that a database of disbursements had not been prepared, and was no longer in development.

Procedures

For our sample of RRRP disbursements we found that key internal controls were followed, except for the following exceptions:

Findings

- 4.7.5 We were unable to obtain supporting documentation for one Disbursing Agent (\$6,904,627).
- 4.7.6 We found eight cases where disbursements did not have invoices attached (\$894,223).
- 4.7.7 We found 22 cases where we were unable to obtain goods received notes or other supporting documentation for disbursements (\$3,250,605).
- 4.7.8 We found three cases where the nature of disbursements could not be determined due to a lack of supporting documentation (\$193,622).
- 4.7.9 We found 39 cases where disbursements did not have contracts attached (\$2,565,304).

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

4.7.10 We found 20 contracts where we were unable to obtain evidence that three bids were obtained, or documented justification for contracts awarded on a non-competitive basis (\$20,982,208).

We were informed by the RRRP Program Coordinator that competitive bidding was not always possible in certain regions due to security constraints, difficulty in accessing local contractors and tribal matters.

4.7.11 We found 25 cases where evidence of contract monitoring for closed contracts had not been documented in the contract file (contract value of \$26,972,201).

4.7.12 We were informed by the DFI Disbursing Office that there are ongoing investigations for eight RRRP and two CERP Disbursing Agents, of which four cases were noted in our Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004. The remaining six investigations relate to unsupported disbursements and supporting documentation in excess of funds advanced (net amount of \$641,796).

Development Fund for Iraq
Report of Factual Findings
in connection with Disbursements, continued
For the period from 29 June 2004 to 31 December 2004
(all amounts are in US dollars)

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 29 June 2004 to 31 December 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 29 June 2004 to 31 December 2004, with our audit report issued thereon on 6 April 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.

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.

Manama, Kingdom of Bahrain
6 April 2005

K P M G

**Development Fund for Iraq
Agreed-Upon Procedures
in connection with Disbursements
For the period from 29 June 2004 to 31 December 2004**

Appendix A

In accordance with the engagement letter issued on 13 December 2004, 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.