DEVELOPMENT FUND FOR IRAQ: DEPARTMENT OF DEFENSE NEEDS TO IMPROVE FINANCIAL AND MANAGEMENT CONTROLS

SIGIR 10-020
JULY 27, 2010
July 27, 2010

DEVELOPMENT FUND FOR IRAQ: DEPARTMENT OF DEFENSE NEEDS TO IMPROVE FINANCIAL AND MANAGEMENT CONTROLS

What SIGIR Found

Weaknesses in DoD’s financial and management controls left it unable to properly account for $8.7 billion of the $9.1 billion in DFI funds it received for reconstruction activities in Iraq. This situation occurred because most DoD organizations receiving DFI funds did not establish the required Department of the Treasury accounts and no DoD organization was designated as the executive agent for managing the use of DFI funds. The breakdown in controls left the funds vulnerable to inappropriate uses and undetected loss.

The Department of the Treasury established guidance for accounting for non-U.S. government funds when U.S. agencies act as a custodian of those funds, but DoD did not implement the guidance in a timely manner. More importantly, most DoD organizations that received DFI funds did not follow the guidance. Only one of these organizations established the required account and, as a result, accounts were not established for $8.7 billion (96%) of the DFI funds made available to DoD.

DoD’s guidance also directed organizations that received DFI funds to reconcile all transactions prior to the time the guidance was issued. However, the reconciliations were not done. Due to the lack of records and personnel knowledgeable about financial and management decisions, we could not determine why the guidance was not followed. Because the accounts were not reconciled, DoD must rely on its organizations’ accounting records to determine the status of DFI funds. Our selective review shows the records were not always complete. For example, DoD could not provide documentation to substantiate how it spent $2.6 billion.

We also found differences in DoD contracting practices that impacted the return of DFI funds to the GOI. The Joint Contracting Command-Iraq/Afghanistan contracted on behalf of the GOI, while USACE and the U.S. Air Force Center for Engineering and the Environment (AFCEE) contracted on behalf of the U.S. government making those agencies potentially liable for payment. As a result, USACE and AFCEE could not terminate their contracts and return remaining DFI funds when the GOI directed DoD to do so at the end of 2007.

The lack of oversight and guidance has contributed to DoD organizations continuing to hold DFI funds. We found organizations with open contracts that were holding funds, and also spending funds in some cases. USACE and one of its contractors and the U.S. Army Central Command (ARCENT) are holding about $5.4 million and $28.9 million, respectively. In October 2009, SIGIR recommended that DoD provide guidance to USACE on the use and ultimate disposition of funds it was still holding. However, DoD has still not issued the guidance and the funds that USACE and ARCENT are holding are at risk of being expended. While DoD has taken steps to provide guidance for future contingency operations, the guidance does not cover the accounting and reporting of funds such as occurred with the DFI in Iraq.

Recommendations

SIGIR recommends that the Secretary of Defense take a number of actions to include specifying procedures for the accounting and reporting of non-U.S. funds in future contingencies, designating an executive agent to establish and oversee policy on the use of funds, establishing milestones for issuing guidance consistent with our DFI recommendations made in October 2009, and determining whether DoD organizations are still holding DFI funds.

Management Comments and Audit Response

We received comments from the Office of the Under Secretary of Defense, (Comptroller), U.S. Army Corps of Engineers (USACE), and U.S. Central Command on a draft of this report. The Comptroller concurred with the report recommendations. USACE and U.S. Central Command provided technical comments that we addressed where appropriate.

For more information, contact SIGIR Public Affairs at (703) 428-1100 or PublicAffairs@sigir.mil

Special Inspector General for Iraq Reconstruction
SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

July 27, 2010

MEMORANDUM FOR THE U.S. SECRETARY OF DEFENSE

SUBJECT: Development Fund for Iraq: Department of Defense Needs To Improve Financial and Management Controls (SIGIR 10-020)

We are providing this audit report for your information and use. The report discusses the Department of Defense’s accountability for funds received from the Development Fund for Iraq. We performed this audit in accordance with our statutory responsibilities contained in Public Law 108-106, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978. This law provides for independent and objective audits of programs and operations funded with amounts appropriated or otherwise made available for the reconstruction of Iraq, and for recommendations on related policies designed to promote economy, efficiency, and effectiveness and to prevent and detect fraud, waste, and abuse. This audit was conducted as Project 1006a.

The Office of the Under Secretary of Defense (Comptroller), U.S. Army Corps of Engineers, and U.S. Central Command provided written comments on a draft of this report, and the comments are included in Appendix D. We considered these comments in preparing this report and addressed them in the report where appropriate.

We appreciate the courtesies extended to our staff. For additional information on the report, please contact David Warren, Assistant Inspector General for Audits, (703) 604-0982/ david.warren@sigir.mil or Glenn Furbish, Principal Deputy Assistant Inspector General for Audits, (703) 604-1388/ glenn.furbish@sigir.mil.

Stuart W. Bowen, Jr.
Special Inspector General for Iraq Reconstruction

cc: U.S. Secretary of State
    U.S. Ambassador to Iraq
    U.S. Under Secretary of Defense (Comptroller)
    U.S. Assistant Secretary of the Army (Financial Management and Comptroller)
    U.S. Assistant Secretary of the Navy (Financial Management and Comptroller)
    Commander, U.S. Central Command
    Commanding General, U.S. Forces-Iraq
    Commanding General, U.S. Army Corps of Engineers
    Director, Air Force Center for Engineering and the Environment
    U.S. Secretary of the Treasury
    Director of the Office of Management and Budget
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Development Fund for Iraq: Department of Defense Needs To Improve Financial and Management Controls

SIGIR 10-020

July 27, 2010

Introduction

Since January 2004, the Department of Defense (DoD) has received about $9.1 billion from the Development Fund for Iraq (DFI) for reconstruction activities in Iraq. The DFI comprises funds from export sales of petroleum, petroleum products, and natural gas from Iraq, and surplus funds from the United Nations Oil-for-Food Program as well as frozen Iraqi assets. The Fund was established in May 2003 by the Coalition Provisional Authority (CPA) Administrator, and recognized by United Nations Security Council Resolution 1483, dated May 22, 2003. The resolution requires that the funds be used in a transparent manner for: (1) humanitarian needs of the Iraqi people, (2) economic reconstruction and repair of Iraq’s infrastructure, (3) continued disarmament of Iraq, (4) cost of Iraqi civilian administration, and (5) other purposes benefiting the people of Iraq. After the CPA was dissolved in June 2004, the U.S. government was authorized by the Government of Iraq (GOI) to administer the DFI funds made available for reconstruction projects until that authority was withdrawn effective December 31, 2007.

The Special Inspector General for Iraq Reconstruction (SIGIR) previously reported on weaknesses in the U.S. Army Corps of Engineers’ (USACE) accounting for DFI funds and problems with the DoD and Department of State process for facilitating payment of unpaid DFI project invoices. SIGIR is providing this report on DoD’s overall accounting for DFI funds.

Background

The CPA was established in May 2003 for the temporary governance of Iraq following the invasion of Iraq. The CPA Administrator managed DFI funds from May 2003 through June 2004, and CPA Regulation 2, “Development Fund for Iraq,” described the responsibilities for the administration, use, accounting, and auditing of the DFI. The International Advisory and Monitoring Board was established by the United Nations to monitor and audit the use of the DFI. Audit reports completed for the GOI indicated that U.S. government agencies did not maintain a complete and accurate database of reconstruction contracts awarded by the CPA.

The CPA was dissolved in June 2004. The Interim Iraqi Government was responsible for administering Iraq’s affairs until the permanent Government of Iraq was formed in 2006. In June 2004, control of the DFI was transferred to the GOI and the Iraq Minister of Finance was assigned responsibility for managing the DFI. The Minister of Finance established two accounts

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1 This figure updates information previously reported in Development Fund for Iraq: Policy Guidance Needed To Enhance Accountability of USACE-managed Funds, SIGIR 10-006, 10/29/2009.
3 The International Advisory and Monitoring Board performed several audits of the DFI. The audit reports that we reviewed are listed in Appendix A.
within the Federal Reserve Bank of New York for DFI funds: (1) the Central Bank of Iraq account (also known as the main account), and (2) the DFI sub-account (also known as the secondary account). The sub-account was available to U.S. government agencies for their use, with GOI approval, in administering DFI contracts. Since January 2004, USACE received almost $1.3 billion from the DFI main account and $827.6 million from the DFI sub-account for relief and reconstruction contracting activities in Iraq.4

In addition to funds provided from the DFI main account and sub-account, DoD received DFI funds from three other sources. When the CPA dissolved, $6.6 billion was transferred from the CPA Comptroller to the Joint Area Support Group-Central (JASG-C) Comptroller, a DoD organization whose role was, in part, to manage and control the DFI funds transferred to it from the CPA. Some of the money was intended to pay for ongoing reconstruction contracts, but other funds were available for new contracts. In March 2008, $24.5 million in remaining cash was returned to the GOI. Also, the Interim Iraqi Government provided $136.0 million in 2004 and 2005 from the Central Bank of Iraq for the Commander’s Emergency Response Program (CERP). The GOI later provided $270.0 million in 2008 to fund Iraq-Commander’s Emergency Response Program (I-CERP) projects. All five sources of funds are listed in Table 1.

Table 1: Sources of DFI Funds Made Available to DoD Since 2004 ($ millions)

<table>
<thead>
<tr>
<th>Source</th>
<th>Year(s) Received</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>DFI Main Account</td>
<td>2004</td>
<td>$1,274.8</td>
</tr>
<tr>
<td>DFI Sub-account</td>
<td>2004</td>
<td>827.6</td>
</tr>
<tr>
<td>Cash Transferred from the CPA</td>
<td>2004</td>
<td>6,641.1</td>
</tr>
<tr>
<td>Interim Iraqi Government</td>
<td>2004-05</td>
<td>136.0</td>
</tr>
<tr>
<td>Government of Iraq</td>
<td>2008</td>
<td>270.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$9,149.5</strong></td>
</tr>
</tbody>
</table>

Source: SIGIR analysis of DoD data as of 06/10/2010.

From June 2004 through December 2007, the Minister of Finance gave DoD the authority to monitor and confirm performance, certify and/or make payments, and otherwise administer the DFI-funded contracts and grants it had awarded. In addition to the JASG-C, we have identified seven other DoD organizations that shared these responsibilities: (1) U.S. Army’s Project and Contracting Office for Iraq, (2) USACE, (3) U.S. Army Central Command (ARCENT), (4) Multi-National Corps-Iraq (MNC-I), (5) Joint Contracting Command Iraq/Afghanistan (JCC-I/A),5 (6) U.S. Air Force Center for Engineering and the Environment (AFCEE), and (7) Department of the Navy.

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4 The DFI sub-account also included an additional $2.1 billion in deposits by the end of 2004. These funds were used for electronic fund transfers to contractor bank accounts as well as to establish letters of credit at financial institutions to facilitate future payments on approved projects. These projects involved contracts administered by DoD agencies.

5 The U.S. Central Command’s Joint Theater Support Contracting Command subsumed JCC-I/A’s activities on June 11, 2010. This new command is commonly known as the CENTCOM Contracting Command.
JCC-I/A was the last organization to have such authority when the U.S. stewardship over the DFI ended; however, it never received or managed DFI funds. Specifically, the Minister of Finance, in a letter to the Commander, JCC-I/A, agreed to extend JCC-I/A’s authority to administer DFI-funded contracts until December 31, 2007. In this letter, the Minister of Finance specified that JCC-I/A should not award any new contracts after that date, nor renew or extend any previously awarded contracts. The Minister also noted that all contracts were to be completed by December 31, 2007, and that remaining funds were to be transferred from the sub-account to the main account. SIGIR’s prior work has noted problems with DoD’s DFI accounting and raised questions as to whether DoD can fully identify the DFI funds potentially remaining in its accounts (see Appendix A for a list of these reports). The vulnerability of not having proper financial and management controls over these types of funds was demonstrated in a 2005 SIGIR report addressing paying agent activities in the South-Central Region of Iraq. The report concluded that the paying agents and the DFI Account Manager could not properly account for or support more than $96.6 million in cash and receipts. Consequently, SIGIR conducted a criminal investigation of the use of these funds which resulted in 8 convictions of CPA and DoD officials for bribery, fraud, and money laundering; and $7.8 million in fines, forfeitures, and restitution payments.

**Objective**

Our reporting objective is to determine whether DoD organizations adequately accounted for the funds they received from the DFI.

While we were able to achieve the objective of our audit, our work was limited by a lack of records maintained by the DoD organizations that received DFI funds. Additionally, we were unable to locate personnel with knowledge of DFI activities in the 2003-2005 timeframe when the largest part of the DFI contracting activities occurred.

For a discussion of the audit scope and methodology, see Appendix A. For a list of acronyms, see Appendix B. For the audit team members, see Appendix C. For management comments, see Appendix D. For the SIGIR mission and contact information, see Appendix E.

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6 *Control of Cash Provided to South-Central Iraq*, SIGIR 05-006, 04/30/2005.
DoD’s Financial and Management Controls for DFI Funds Need Improvement

Weaknesses in DoD’s financial and management controls left it unable to properly account for $8.7 billion of the $9.1 billion in DFI funds it received for reconstruction activities in Iraq. The Department of the Treasury established guidance for accounting for non-U.S. government funds when U.S. agencies were acting as a custodian of those funds. DoD did not establish the guidance in a timely manner, but more importantly, once established the guidance was not followed. Because the guidance was not followed, DoD must rely on its organizations’ accounting records to determine the status of DFI funds. Our selective review shows the records were not always complete.

Additionally, DoD did not designate an executive agent responsible for developing policy or overseeing the use of DFI funds and key information on using DFI funds was not transmitted to the organizations that received funds. Instead, organizations were left to act at their own discretion on contracting approaches, and some organizations wrote DFI contracts in a manner that has made the U.S., rather than the GOI, potentially liable. DoD organizations also continue to keep contracts open and are holding and spending DFI funds in some cases. SIGIR previously recommended that DoD provide guidance on the use and ultimate disposition of funds being held by USACE but DoD has still not issued the guidance. Also, unless DoD or other responsible agencies establish and follow guidance in future contingencies, they will be unable to account for similar funds making them vulnerable to inappropriate uses and undetected loss.

DoD Did Not Establish Required Financial Controls for the DFI

DoD did not establish deposit fund accounts within the Department of the Treasury for about $8.7 billion out of the $9.1 billion (about 96%) of the DFI funds it controlled. Treasury Financial Manual Volume 1, Part 2, Chapter 1500, Section 1535—Deposit Funds Accounts—states that the Financial Management Service’s Budget Reports Division is to establish deposit fund accounts for agencies to record monies that do not belong to the Federal government. Treasury’s guidance states that to maintain accountability agencies must establish separate deposit fund accounts to hold non-U.S. government funds, such as from a foreign government, for individual statutory authorizations or programs, for which the U.S. government is acting solely as a banker, fiscal agent, or custodian. These accounts, a key financial management control, enable agencies to maintain accountability for non-U.S. government funds by tracking obligations and expenditures on a monthly basis, just as they would with U.S.-appropriated funds. According to a Treasury official, DFI funds are subject to this requirement, and each U.S. government agency possessing DFI funds is responsible, in consultation with the Office of Management and Budget, for requesting that the deposit fund account be established.

The DoD Under Secretary of Defense (Comptroller) issued guidance for establishing deposit fund accounts. However, the guidance was not issued until December 2004, about six months after most of the DFI funds had been made available to DoD organizations for reconstruction. This guidance provided the Assistant Secretary of the Army (Financial Management and Comptroller) direction on the establishment of a deposit fund account in accordance with the
Treasury Financial Manual and noted that it applied to all parties involved in the receiving, disbursing, accounting for, securing, and reporting of DFI assets following transition from the CPA to the Interim Iraqi Government. The guidance also directed DoD organizations to develop and implement procedures to reconcile DFI transactions prior to December 2004.

However, only one DoD organization established the required deposit fund account and reported its DFI financial activities to the Department of the Treasury. ARCENT received a total of $136.0 million from the Interim Iraqi Government, the first allocation being received in December 2004, for use in the CERP. At that time, ARCENT deposited the money in a deposit fund account in accordance with the DoD guidance. Later, in 2008, when the GOI provided an additional $270.0 million in DFI funds for the I-CERP, ARCENT managed the funds as a separate budget line in the original deposit fund account. As a result, ARCENT was readily able to provide us with an accounting of its DFI obligations, expenditures, and remaining balances. The other DoD organizations were not readily able to provide that information.

SIGIR found that other DoD organizations that were required to establish separate deposit fund accounts did not do so. It was unclear why some organizations such as JASG-C and the Department of the Navy did not establish separate deposit fund accounts and instead used other processes to track DFI funds. Our ability to determine this was limited due to a lack of personnel that were knowledgeable about the subject and records maintained by these organizations. We found no evidence that DoD organizations reconciled their DFI transactions prior to December 2004. Consequently, DoD is uncertain about the amount of DFI funding made available to DoD or the amount of DFI funding its organizations may be holding. We selectively reviewed available records from eight DoD organizations that received DFI funds and found the information was not always complete. For example:

- During our visit to Iraq, we met with JASG-C officials to discuss their DFI contracting activities associated with these funds. The officials told us they were not in Iraq at that time and, therefore, were not familiar with JASG-C’s DFI activities. The officials provided us with electronic copies for all of JASG-C’s DFI files retained in Iraq. Our review of this information showed that $4.0 billion of the $6.6 billion in cash transferred from the CPA was intended to pay ongoing reconstruction contracts executed by the CPA. However, the electronic records did not show the manner in which these funds were expended. JASG-C returned $24.5 million in cash in March 2008 to the GOI. We could not account for the approximately $2.6 billion in remaining funds made available to JASG-C from these records.

- USACE was the only DoD organization to receive direct funding transfers, totaling about $2.1 billion, from the DFI accounts at the Federal Reserve Bank of New York. In October 2009, SIGIR reported that USACE officials provided us with a computer-generated listing indicating that it received a total of $2.4 billion in DFI funding. However, because it did not establish a single DFI accounting code, USACE experienced difficulty isolating the amount of DFI funding made available to it. In follow-up work, USACE provided us copies of all available electronic fund transfer documents to support the amount of funding the agency received directly from the DFI main and sub-accounts.

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7 SIGIR 10-006.
From the information provided, we could not determine or validate the source of the remaining $300.0 million USACE reportedly received. The gap occurred because the records prior to 2004, including cash receipts in support of early U.S. reconstruction work authorized by the CPA, were not readily available.

- USACE did not establish a separate deposit fund account to report its DFI-funding status to the Department of the Treasury. USACE officials told us they considered the DFI funds as advanced payments for reconstruction work they were planning. As a result, USACE combined the funds with regular appropriations, including Military Construction and Operation and Maintenance, for the purpose of reporting them to the Department of the Treasury.

- MNC-I records show that, as of June 1, 2005, it had about $15.0 million in unexpended DFI funds from the original $368.1 million in total DFI funds it received. MNC-I officials told us that MNC-I did not award contracts itself but instead provided the funds to its subordinate commands to execute DFI contracts. MNC-I officials in Iraq at the time of our audit did not have knowledge or record of the final disposition of the unexpended DFI funds. The officials told us that DFI obligations and disbursements were entered into the Army’s Standard Finance System which is maintained by the Defense Finance and Accounting Service.

The Defense Finance and Accounting Service is responsible for identifying and implementing finance and accounting requirements, systems, and functions for DoD. However, Defense Finance and Accounting Service officials told us they had no record of MNC-I transactions involving DFI. We were unable to find any other office in DoD that could provide us with information on the status of these unexpended funds. Consequently, we could not reconcile MNC-I’s obligations and expenditures for DFI.

- We also could not identify the process and procedures that the Department of the Navy used to track DFI funds. Since the majority of funds were not in deposit fund accounts, we attempted to identify how much DFI the Navy as well as other DoD organizations may have received by querying the Iraq Reconstruction Management System. The data in that system, which captures the status of Iraq reconstruction projects, shows the Navy received $29.2 million in DFI funds. While in Iraq, we located and reviewed several Navy DFI-funded contracts which confirmed that the Navy was involved in DFI contracting activities. We contacted the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) as well as the Naval Facilities Engineering Command and were told they had no knowledge of these DFI contracting activities.

We contacted the Defense Finance and Accounting Service, but they did not have any financial data on the Navy’s DFI-contracting activities. Due to the problems associated with completeness and accuracy of data in the Iraq Reconstruction Management System and lack of readily available financial records, SIGIR is uncertain whether this represents the Navy’s total amount of DFI contracting activities.8

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8 For purposes of this audit, we used the data only to identify DoD organizations that we should talk to about possible DFI contracting activities in Iraq. SIGIR previously reported that the data in this automated system was inconsistent, inaccurate, and incomplete. See Comprehensive Plan Needed To Guide the Future of the Iraq Reconstruction Management System, SIGIR 08-021, 07/26/2008.
DoD’s Management Controls for the DFI Were Inadequate

DoD did not designate an executive agent within DoD to be responsible for establishing and overseeing policy for, or controls over, the use of DFI funds. Also, key information on using DFI funds was not transmitted to all organizations that received funds. DoD has not established management controls to ensure consistent contracting practices when using DFI funds. SIGIR found that some DoD organizations obligated DFI funds on contracts on behalf of the GOI, while other organizations contracted on behalf of the U.S. government. This caused problems when the GOI directed that DFI contracts be terminated at the end of 2007. SIGIR also found that due to the lack of an executive agent to oversee DFI policies within DoD, some organizations did not receive information directing them to terminate contracts and return remaining DFI funds. At least two organizations and one contractor are holding up to $34.3 million in DFI funds. However, as previously discussed, SIGIR cannot be certain of the total amount of DFI funds remaining in DoD organization accounts because of the lack of adequate financial controls.

DoD did not provide guidance on awarding contracts using DFI funds. Lack of guidance for reconstruction contracting in Iraq using DFI funds contributed to organizations conducting their DFI activities differently. For example, JCC-I/A followed the practice put in place by CPA Memorandum #4 and awarded DFI-funded contracts on behalf of the GOI rather than the U.S. government. By contracting in this manner, the U.S. was not liable for payment and resolution of these contracts; instead, the GOI was responsible for them. This enabled JCC-I/A to terminate DFI contracts and arrange for the return of $24.5 million in remaining DFI cash being held by JASG-C almost immediately after the GOI directed it to do so.

Conversely, contracting organizations such as AFCEE and USACE awarded DFI-funded contracts in a manner that could make the U.S. government liable for payment and resolution of the contracts. These organizations issued task orders on existing U.S. contracts in an attempt to speed up the start time of the reconstruction work. Some contractors have DFI invoices that have not been paid by the GOI, and questions have been raised by contracting officials within AFCEE about whether the U.S. government could be liable for paying the outstanding invoices. Further, in a response to a congressional inquiry on DFI contracts, the U.S. Air Force Office of Legislative Liaison, in a letter dated February 12, 2008, stated that contracts issued by AFCEE were awarded with the mutual understanding that payment for work was backed by the authority of the Federal Acquisition Regulation and the U.S. government. Moreover, USACE officials told us that if the preferred method of contracting was between the GOI and the contractor, it was never communicated to them by any organization in DoD. Nonetheless, the practical result of these contracting practices is that USACE and one of its contractors are still holding up to $5.4 million of DFI funds almost 2.5 years after the GOI directed their return.9

Similarly, DoD has not provided Department-wide guidance on terminating contracts and returning funds to the GOI. USACE stated that DoD never directed them to terminate contracts and return remaining DFI funds when the U.S. authority to administer the DFI ended. USACE previously returned $13.1 million to the GOI as the result of a SIGIR investigation, and USACE is awaiting the completion of several audits before making a decision on returning the $5.4

9 The Defense Contract Audit Agency has questioned $2.1 million of the $2.2 million held by a USACE contractor. USACE is responsible for determining whether it will deny the claim and the final disposition of the funds being held by the contractor. USACE had not made its determination prior to the time this report was issued.
million that it and one of its contractors are holding, according to a USACE official. Also, ARCENT officials stated they never received guidance or direction from higher headquarters indicating that residual DFI balances were to be returned to the GOI at the end of 2007, and that no new DFI contracting activities should take place after that date.

In the absence of guidance, ARCENT has continued to spend DFI funds. ARCENT obligated and expended most of its residual DFI balance remaining from the $136.0 million it received in 2004 and 2005 for use in CERP projects. ARCENT records show that on December 31, 2007, it had about $10.1 million in unobligated DFI funds from the $136.0 million it received in 2004-05 to use for CERP projects that could have been returned to the GOI had DoD instructed it to do so. However, a U.S. Army Finance Center official concluded that when the GOI provided an additional $270.0 million for the I-CERP on April 14, 2008, that residual funding from the initial DFI authorizations did not need to be returned. As a result, ARCENT authorized the initiation of five new CERP projects in 2008 and 2009 and continued to spend its unobligated funds from the 2004-05 money. Only $473,000 remained as of May 19, 2010.

Furthermore, $28.4 million remains unobligated of the funds that ARCENT received in 2008. The Memorandum of Understanding covering the implementation and oversight of the I-CERP is silent on if, or when, remaining funds should be returned to the GOI. However, due to the fact that there has been little recent activity in this account, we question whether ARCENT needs to hold the remaining I-CERP funds.

DoD has still not provided guidance on terminating DFI contracts and returning the funds to the GOI. SIGIR previously recommended the Under Secretary of Defense (Comptroller)/Chief Financial Officer develop guidance on the use and ultimate disposition of DFI funds that USACE was holding because the GOI withdrew the U.S.’ authority for administering DFI funds effective December 31, 2007.10 The Under Secretary of Defense concurred and estimated the action would be completed by January 2010. However, as of the issuance of this report, the guidance had still not been issued. SIGIR believes that until DoD issues guidance for its organizations to stop obligating and spending DFI funds, the funds currently held by USACE and ARCENT are at risk of being expended without proper authorization from the GOI.

**Defense Financial Management Regulation Needs To Be Expanded**

In November 2008, DoD established a new chapter within its Financial Management Regulation on administering, using, and accounting for vested and seized funds and property during contingency operations to ensure transparency and accountability of these assets.11 The new chapter, however, does not cover the accounting and reporting of non-U.S. government funds such as the DFI. During our exit conference with the Office of the Secretary of Defense (Comptroller), officials acknowledged the need for updated procedures for the accounting and reporting of all non-U.S. government funds made available to DoD for future contingency operations to prevent inappropriate uses of the funds to deter and detect loss.

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10 SIGIR 10-006.
11 DoD Financial Management Regulation, Volume 12, Chapter 29, Administering, Using and Accounting for Vested and Seized Funds and Property During Contingency Operations. SIGIR has an ongoing audit of Iraqi seized and vested assets and will be reporting the results of this audit later in the year.
Conclusions and Recommendations

Conclusions

Weaknesses in DoD’s financial and management controls left it unable to properly account for $8.7 billion of the $9.1 billion in DFI funds it received for reconstruction activities in Iraq. This situation occurred because most DoD organizations receiving DFI funds did not establish the required Department of the Treasury accounts or reconcile DFI accounts as required by DoD. Only one organization established the required account. DoD cannot readily and completely account for its obligations, expenditures, and remaining balances associated with the DFI. The breakdown in controls left the funds vulnerable to inappropriate uses and undetected loss.

Further, no DoD organization was designated as the executive agent for managing the use of DFI funds. This situation contributed to the lack of timely and adequate guidance on the use and return of DFI funds to the GOI. Differences in contracting practices contributed to DoD’s inability to comply with GOI direction to terminate contracts and return DFI funds. DoD organizations still have open contracts and are holding and spending DFI funds in some cases.

While DoD has taken some steps to provide guidance on the use of non-U.S. government funds in future contingency operations, the guidance does not cover the accounting and reporting of funds such as occurred with the DFI in Iraq. Until it provides such guidance, DoD and other responsible agencies will be unable to properly account for similar funds in future contingencies.

Lastly, DoD has not issued guidance, as we recommended in October 2009, on the use and disposition of remaining DFI funds and, until it does, these funds are at risk of being expended.

Recommendations

SIGIR recommends that the Secretary of Defense direct the:

1. Under Secretary of Defense (Comptroller) to update the DoD Financial Management Regulation to specify procedures for the accounting and reporting of all non-U.S. government funds made available to DoD organizations for use in future contingency operations. This guidance should also include the designation of an executive agent within DoD to be responsible for establishing and overseeing policy on the use of these funds.

2. Under Secretary of Defense (Comptroller) to establish specific milestones for issuing guidance consistent with our recommendation in October 2009.

3. Service Secretaries and the Commander, U.S. Central Command to determine the amount of DFI funds their respective organizations received and whether they are still holding any of those funds. At a minimum, these organizations would include the: (1) JASG-C, (2) U.S. Army’s Project and Contracting Office for Iraq, (3) USACE, (4) ARCENT, (5) MNC-I, (6) JCC-I/A, (7) AFCEE, and (8) Department of the Navy.
Management Comments and Audit Response

The Under Secretary of Defense (Comptroller), USACE, and U.S. Central Command provided SIGIR written comments. The Deputy Chief Financial Officer concurred with our recommendations and identified specific actions it plans to take, and stated that all actions would be completed by November 2010. SIGIR believes the identified actions, if implemented as planned, will address SIGIR’s concerns.

USACE and U.S. Central Command provided technical comments. Each stated it was concerned with the draft report statement that DoD was unable to account for $8.7 billion of the $9.1 billion of the DFI funds it received for reconstruction activities in Iraq. USACE noted that it was able to provide information on $2.0 billion of DFI it received and U.S. Central Command stated the lack of a deposit fund account does not result in lack of accountability for all of the funds DoD received. Based on these comments, we clarified our statement to note that DoD had not properly established the required deposit fund accounts at the Department of the Treasury for $8.7 billion of the $9.1 billion it received.

USACE and U.S. Central Command provided other technical comments that SIGIR addressed where appropriate.
Appendix A—Scope and Methodology

Scope and Methodology

In November 2009, the Special Inspector General for Iraq Reconstruction (SIGIR) initiated Project 1006a as part of its series of audits on the Development Fund for Iraq (DFI). Our reporting objective is to determine whether Department of Defense (DoD) organizations adequately accounted for the funds they received from the DFI. This audit was performed under the authority of Public Law 108-106, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978. SIGIR conducted its work from November 2009 through June 2010 in the United States and Iraq.

While we were able to achieve the objective of our audit, our work was limited by a lack of records maintained by DoD organizations that received DFI funds. Additionally, we were unable to locate personnel with knowledge of DFI activities in the 2003-2005 timeframe when the largest part of the DFI contracting activities occurred.

To identify DoD organizations that participated in DFI contracting activities in Iraq, as a starting point, we relied on information contained in the Iraq Reconstruction Management System. SIGIR previously reported that Iraq Reconstruction Management System data suffered from a lack of consistency, accuracy, and completeness. However, for purposes of this audit, we used the data primarily to identify DoD organizations that may have received DFI funds for use in reconstruction activities. Additionally, we selectively reviewed the records of the eight DoD organizations we identified as receiving DFI funds. We tested those records to assess their completeness and accuracy.

To evaluate the adequacy of financial controls over DFI funds, we reviewed financial records and met with officials from the Department of the Treasury; Office of the Secretary of Defense (Comptroller); Assistant Secretary of the Army (Financial Management and Comptroller); and the U.S. Army Corps of Engineers, Millington, Tennessee. We also reviewed financial records during site visits to the Defense Finance and Accounting Service in Rome, New York and Indianapolis, Indiana, as well as the Federal Reserve Bank of New York. In addition, we reviewed prior SIGIR, International Advisory and Monitoring Board, and other reports addressing the adequacy of financial controls over the DFI.

To attempt to determine whether DoD organizations were still holding DFI funds, we reviewed documents and met with officials from the Office of Management and Budget; Department of State; Department of the Treasury; Office of the Secretary of Defense (Comptroller); Assistant Secretary of the Army (Financial Management and Comptroller); U.S. Army Budget Office; U.S. Army Central Command; U.S. Army Corps of Engineers; the Department of the Navy; and the U.S. Air Force Center for Engineering and the Environment. In Iraq, we reviewed DFI files and met with officials from the Joint Contracting Command-Iraq/Afghanistan, Multi-National Corps-Iraq, Joint Area Support Group-Central, and the U.S. Army Corps of Engineers.

The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that SIGIR plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. SIGIR believes that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

**Use of Computer-processed Data**

To determine the amount of DFI funding that DoD organizations received, we reviewed a variety of computer-generated reports. For example, we reviewed computer-generated listings of deposits and disbursements from the DFI sub-account at the Federal Reserve Bank of New York, fund status reports developed by the Defense Finance and Accounting Service, and computer-generated spreadsheets provided by the Joint Area Support Group-Central. Where records were available, we cross-checked these records with the computer-processed data to ensure accuracy of the data retrieved from the computer systems. For example, we compared the balances on the Defense Finance and Accounting Service-generated records to similar information contained in Department of the Treasury records. As stated throughout this report, comprehensive historical records depicting the DFI funding history and current status were generally not available. However, we consider the computer-generated data provided to and collected by SIGIR, including those contained in the Iraq Reconstruction Management System, to be sufficiently reliable for the purposes for which they are used in this audit.

**Internal Controls**

In conducting this audit, we reviewed DoD’s internal management and financial controls for administering the DFI. As a key part of these controls, we reviewed the Department of the Treasury’s Financial Manual addressing the requirement to establish deposit fund accounts for agencies to record monies that do not belong to the Federal government. We also reviewed DoD’s Financial Management Regulation, other DoD guidance and fund status reports, and held discussions with key officials to gain an understanding of the internal controls governing the use of DFI funds. We also considered comments and conclusions in independent audit reports concerning the adequacy of DoD’s internal controls over the DFI. The reports we reviewed are listed below. We presented the results of our review of internal controls in this report as appropriate.

**Related Audit Reports**


*Special Inspector General for Iraq Reconstruction*

Development Fund for Iraq: Policy Guidance Needed To Enhance Accountability of USACE-
managed Funds, SIGIR 10-006, 10/29/2009.

Comprehensive Plan Needed To Guide Future of the Iraq Reconstruction Management System,
SIGIR 08-021, 07/26/2008.

Attestation to Development Fund for Iraq Cash in the Possession of the Joint Area Support
Group-Central, SIGIR 08-012, 03/13/2008.


Follow-up on SIGIR Recommendations Concerning the Development Fund for Iraq (DFI),


Administration of Contracts Funded by the Development Fund for Iraq, SIGIR 05-008,
04/30/2005.

Control of Cash Provided to South-Central Iraq, SIGIR 05-006, 04/30/2005.

Coalition Provisional Authority Comptroller Cash Management Controls Over the Development

Department of Defense

Internal Controls Over Payments Made in Iraq, Kuwait and Egypt, Department of Defense,

Defense Contract Audit Agency


U.S. Army Audit Agency

Accounting for Seized Assets and Development Fund for Iraq Balances, USAAA, Audit Report:
A-2008-0109-FFM, 05/22/2008.

International Advisory and Monitoring Board

Development Fund for Iraq, Statement of Cash Receipts and Payments, for the year ended
31 December 2007, Independent Auditor’s Report, Ernst and Young, 06/12/2008.

Development Fund for Iraq, Statement of Cash Receipts and Payments, for the year ended
31 December 2006, Independent Auditor’s Report, Ernst and Young, 07/05/2007.

Development Fund for Iraq, Statement of Cash Receipts and Payments, for the period from


U.S. House of Representatives

# Appendix B—Acronyms

<table>
<thead>
<tr>
<th>ACRONYM</th>
<th>DESCRIPTION</th>
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<tbody>
<tr>
<td>AFCEE</td>
<td>Air Force Center for Engineering and the Environment</td>
</tr>
<tr>
<td>ARCENT</td>
<td>Army Central Command</td>
</tr>
<tr>
<td>CERP</td>
<td>Commander's Emergency Response Program</td>
</tr>
<tr>
<td>CPA</td>
<td>Coalition Provisional Authority</td>
</tr>
<tr>
<td>DFI</td>
<td>Development Fund for Iraq</td>
</tr>
<tr>
<td>DoD</td>
<td>Department of Defense</td>
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<tr>
<td>GOI</td>
<td>Government of Iraq</td>
</tr>
<tr>
<td>I-CERP</td>
<td>Iraq-Commander's Emergency Response Program</td>
</tr>
<tr>
<td>JASG-C</td>
<td>Joint Area Support Group-Central</td>
</tr>
<tr>
<td>JCC-I/A</td>
<td>Joint Contracting Command-Iraq/Afghanistan</td>
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<tr>
<td>MNC-I</td>
<td>Multi-National Corps-Iraq</td>
</tr>
<tr>
<td>SIGIR</td>
<td>Special Inspector General for Iraq Reconstruction</td>
</tr>
<tr>
<td>USACE</td>
<td>U.S. Army Corps of Engineers</td>
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</tbody>
</table>
Appendix C—Audit Team Members

This report was prepared and the audit conducted under the direction of David R. Warren, Assistant Inspector General for Audit, Office of the Special Inspector General for Iraq Reconstruction. The staff members who conducted the audit and contributed to the report include:

Benjamin H. Comfort
M. Glenn Knoepfle
Jason G. Venner
L. Michael Welsh
MEMORANDUM FOR ASSISTANT SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION AUDITS

SUBJECT: Comments to Draft Audit Report, “Development Fund for Iraq: Department of Defense Needs to Improve Financial and Management Controls” (SIGR 10-020)

This memorandum forwards the Under Secretary of Defense (Comptroller) response to the subject draft Special Inspector General for Iraq Reconstruction report, dated July 7, 2010. A copy of the response is attached.

We appreciate the opportunity to comment on the draft audit report. My staff point of contact is Ms. Audrey Clark. She can be reached at 703-602-0370 or audrey.clark@osd.mil.

Mark L. Easton
Deputy Chief Financial Officer

Attachment:
As stated
SIGIR DRAFT REPORT - DATED JULY 7, 2010
SIGIR 10-020

"DEVELOPMENT FUND FOR IRAQ (DFI): DEPARTMENT OF DEFENSE NEEDS TO IMPROVE FINANCIAL AND MANAGEMENT CONTROLS"

OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER) (OUSD(C)) COMMENTS TO THE SIGIR RECOMMENDATIONS

SIGIR recommends that the Secretary of Defense direct the:

RECOMMENDATION 1: Under Secretary of Defense (Comptroller) to update the DoD Financial Management Regulation to specify procedures for the accounting and reporting of all non-U.S. government funds made available to DoD organizations for use in future contingency operations. This guidance should also include the designation of an executive agent within DoD to be responsible for establishing and overseeing policy on the use of these funds.

OUSD(C) RESPONSE: Concur. The Under Secretary of Defense (Comptroller) will collaborate with the Office of the Secretary of Defense (OSD) (Acquisition, Technology, and Logistics (AT&L)), OSD Policy, the Office of General Counsel (Fiscal), and Defense Finance and Accounting Service to update the DoD Financial Management Regulation to specify procedures for the accounting and reporting of all non-U.S. government funds made available to DoD organizations. The guidance will also include the requirement to designate an executive agent within DoD to be responsible for establishing and overseeing overall policy on the use of non-U.S. government funds in future contingency operations. Estimated completion date is November 2010.

RECOMMENDATION 2: Under Secretary of Defense (Comptroller) to establish specific milestones for issuing guidance consistent with our recommendation in October 2009.

OUSD(C) RESPONSE: Concur. The Deputy Chief Financial Officer will issue a policy memorandum to the DoD Components consistent with the recommendations from the ‘Development Fund for Iraq: Policy Guidance Needed to Enhance Accountability for USACE Funds’ audit issued in October 2009. As recommended, the policy memorandum will include guidance on: (1) the use and ultimate disposition of DFI funds that DoD Components and/or their contractors are holding; (2) whether the DFI funds can be used to pay in-house and overhead expenses associated with DFI contracts; and (3) how interest that might have been earned by several contractors on disallowed payments should be handled. Additionally, the policy memorandum will include the requirement that the Components identify the amount of DFI funds received for their respective
organization and whether they and/or their contractors are still holding any DFI funds as recommended in this audit. Estimated completion date is September 2010.

RECOMMENDATION 3: Service Secretaries and the Commander, U.S. Central Command to determine the amount of DFI funds their respective organizations received and whether they are still holding any of those funds. At a minimum, these organizations would include the: (1) Joint Area Support Group - Central, (2) U.S. Army's Project and Contracting Office for Iraq, (3) U.S. Army Corps of Engineers, (4) Army Central Command, (5) Multi-National Corps-Iraq (6) Air Force Center for Engineering and the Environment, and (8) Department of the Navy.

OUSD(C) RESPONSE: Concur. The Deputy Chief Financial Officer will issue a memorandum (data call) to all the DoD Components to include the Service Secretaries and the Commander, U.S. Central Command to determine the amount of DFI funds their respective organizations received and whether they are still holding residual funds. Estimated completion date is September 2010.
SIGIR DRAFT REPORT – DATED 7 Jul 2010
SIGIR Audit 10-020
Development Fund for Iraq: Department of Defense Needs to Improve Financial and Management Controls

CENTCOM COMMENTS TO THE DRAFT REPORT

SIGIR recommends the Secretary of Defense direct:

RECOMMENDATION 3. (page 11, SIGIR Draft)
Service Secretaries and the Commander, U.S. Central Command to determine the amount of DFI funds their respective organizations received and whether they are still holding any of those funds. At a minimum, these organizations would include the: (1) JASG-C, (2) U.S. Army’s Procurement and Contracting Office for Iraq, (3) USACE, (4) ARCENT, (5) MNC-I, (6) JCC-I/A, (7) AFCEE, and (8) Department of the Navy.

USF-I: USF-I concurs partially with information provided in this report.

GENERAL COMMENTS ON THE REPORT

1. (U) Page 5. The first sentence reads: “Weaknesses in DoD’s financial and management controls leaves it unable to account for $8.7 billion of the $9.1 billion in DFI funds it received for reconstruction activities in Iraq.” This is a mischaracterization of the facts intended to support this finding. The report backs up this assertion by stating “DoD did not establish deposit fund accounts within the Department of the Treasury for $8.7 billion of the $9.1 billion of the DFI funds it controlled.” The fact that deposit accounts were not established does not translate to $8.7 billion being unaccountable. The documents that would account for much of the $8.7 billion are likely archived at a stateside location. As noted in table 1, page 3 of the report, the entire $8.7 billion listed as unaccounted for was received by DoD agencies in 2004. With no legal requirement to store financial documents beyond one year of execution at the office of execution, it’s likely that many documents accounting for the expenditure of the $8.7 billion are not found.

2. (U) Recommend replacing the first sentence of Page 5, Page 11 and the first sentence of the unnumbered summary page with the following: “DoD did not establish deposit fund accounts within the Department of the Treasury for $8.7 billion of the $9.1 billion of the DFI funds it controlled. As a result, attempting to account for $8.7 billion of the DFI funds controlled by DoD would require significant archival retrieval efforts.”

APPROVED BY:
PAUL CHAMBERLAIN
COL US ARMY
Director, USF-I J8
21 July 2010

PREPARED BY:
JOHN ROUB
MAJ US ARMY
USF-I J8, DSN: 318-483-2527
MEMORANDUM FOR RECORD

20 July 2010

C3-COS

SUBJECT: CT - (0708-005) SIGIR Draft Audit Report 10-020, Development Fund for Iraq: Department of Defense Needs To Improve Financial and Management Controls – SIN20100709147

1. This memorandum is in response to CT - (0708-005) SIGIR Draft Audit Report 10-020, Development Fund for Iraq (DFI), Department of Defense Needs To Improve Financial and Management Controls.

2. The draft report discusses the Department of Defense's accountability for funds received from the DFI.

3. SIGIR requests comments on recommendation #3 in the draft report. The recommendation states that the Service Secretaries and the Commander, U.S. Central Command are to determine the amount of DFI funds their respective organizations received and whether they are still holding any of those funds.

4. According to the SIGIR report, CENTCOM Contracting Command (C³) was the last to have authority to both confirm performance of, and administer, the DFI-funded contracts. While C³ was the last to have such authority when the U.S. stewardship over the DFI ended, C³ has never received or managed any DFI funds.

5. POC is LTC William Canale, William.canale@iraq.centcom.mil, USN 518-485-4699.

[Signature]

GREGORY F. STROH
CAPT, SC, USN
Chief of Staff
MEMORANDUM FOR SPECIAL INSPECTOR GENERAL IRAQ RECONSTRUCTION

SUBJECT: USACE Response to 10-020 - Development Fund for Iraq: Department of Defense Needs to Improve Financial and Management Controls

1. The U.S. Army Corps of Engineers (USACE) appreciates the opportunity to review the draft report and provide comments.

2. As the recommendations were directed to the Under Secretary of Defense (Comptroller), Service Secretaries and CENTCOM, USACE is not providing responses to the recommendations. However, USACE has a number of comments on certain language in the report where there are omissions or mischaracterizations.

   a. It should be pointed out that USACE has provided detailed information for over $2 Billion dollars of Development Fund for Iraq (DFI) received. Any discrepancies in the final amounts are due to the funds not being properly identified and supporting documentation being maintained by the Coalition Provisional Authority (CPA) in the first instance.

   b. The remaining DFI funds that USACE is holding are because we are waiting for final Defense Contract Audit Agency (DCAA) audits of the contracts to determine whether funds are owed to the Government from the contractors or vice versa. USACE believes it would be inappropriate to return those funds before completion of the DCAA audits.

3. My point of contact for these comments is John Daley (202-761-5344).

FOR THE COMMANDER:

[Signature]

Encl

Wesley C. Miller
Director of Resource Management
### Appendix E—SIGIR Mission and Contact Information

#### SIGIR’s Mission
Regarding the U.S. reconstruction plans, programs, and operations in Iraq, the Special Inspector General for Iraq Reconstruction provides independent and objective:
- oversight and review through comprehensive audits, inspections, and investigations
- advice and recommendations on policies to promote economy, efficiency, and effectiveness
- deterrence of malfeasance through the prevention and detection of fraud, waste, and abuse
- information and analysis to the Secretary of State, the Secretary of Defense, the Congress, and the American people through Quarterly Reports

#### Obtaining Copies of SIGIR Reports and Testimonies
To obtain copies of SIGIR documents at no cost, go to SIGIR’s Web site (www.sigir.mil).

#### To Report Fraud, Waste, and Abuse in Iraq Relief and Reconstruction Programs
Help prevent fraud, waste, and abuse by reporting suspicious or illegal activities to the SIGIR Hotline:
- Web:  www.sigir.mil/submit_fraud.html
- Phone:  703-602-4063
- Toll Free:  866-301-2003

#### Congressional Affairs
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