

Development Fund for Iraq

Agreed-Upon Procedures Report

For the period from 22 May 2003 to 31 December 2003

(Disbursements)

KPMG Bahrain

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This report contains 16 pages



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Independent Accountants' Report on Applying Agreed-Upon Procedures

To the International Advisory and Monitoring Board of the
Development Fund for Iraq
To the Coalition Provisional Authority

We have performed the procedures enumerated in the attached Appendix, which were agreed to by the International Advisory and Monitoring Board of the Development Fund for Iraq and the Coalition Provisional Authority, solely to assist you in evaluating the Development Fund for Iraq's compliance with United Nations Security Council Resolution (UNSCR) 1483 paragraph 14, for the period from inception (22 May 2003) to 31 December 2003. The Coalition Provisional Authority is 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 Auditing 920: Agreed-Upon Procedures Regarding Financial Information and with the International Organization of Supreme Audit Institutions (INTOSAI) Standards in Government Auditing.

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



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

1.1 Procedure

We documented the key internal controls at the Coalition Provisional Authority (CPA) over the disbursement of resources to, and on behalf of, Iraqi Ministries. Iraqi Ministries consist of Ministries and other governmental organizations responsible for implementing the program for which the disbursement from the Development Fund for Iraq (the “Fund” or “DFI”) is made.

1.2 Key internal controls

- 1.2.1 An interim budget was issued in July 2003 for the period from July to December 2003 and subsequently revised in October 2003. The budget was prepared using existing systems, forms and formats traditionally used in Iraqi budgets and prepared by each Ministry, in consultation with CPA Senior Advisors. The proposed budget was then reviewed by appropriate officials from the Iraqi Ministries of Finance and Planning, and approved by the CPA Program Review Board (PRB).
- 1.2.2 The PRB was responsible for recommending expenditure of resources from the Fund and other sources to the CPA Administrator. The PRB was also responsible for reviewing all identified resource requirements, and their subsequent prioritization and integration into a funding plan. The funding plan forecasts available resources, recommends allocation of these resources and justifies the proposed expenditures and the recommended manner of expenditures. All funding plans and programs were to be recommended for approval by the PRB prior to approval by the CPA Administrator.
- 1.2.3 A Program Review Committee (PRC) was established by the PRB to assist the CPA and Iraqi officials in co-ordinating programs prior to submission to the PRB and minutes of the meetings were not kept.
- 1.2.4 CPA Regulation 3 dated 15 June 2003 states all programs were to be approved, on a majority basis, by eleven voting members of the PRB, including one Iraqi representative from the Ministry of Finance (MoF). CPA Regulation 3 also states the PRB could only take official actions in formal sessions at which no fewer than 70% of the voting members of the Board are present.

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- 1.2.5 The PRB met on a regular basis to discuss and recommend specific programs not included in the 2003 Iraqi budget for approval. All programs recommended by the PRB and subsequently approved by the CPA Administrator, requiring contractual assistance, were to be transferred to the CPA Contracting Unit (CU). The role of the CU was to issue a Request for Proposal (RFP), evaluate bids received, award the contract and subsequently monitor the performance of the contractor as set out in CPA Memorandum 4.
- 1.2.6 Competition for contracts in excess of \$500,000 was mandatory and three bids were to be obtained, unless circumstances required the award of a contract without competition and written justification was to be documented in the contract file. A Technical Committee appointed by the CU officer, consisting of three or more officials, was responsible for approving the award decision.
- 1.2.7 Disbursements were to be made to the MoF in accordance with the amended 2003 Iraqi operating budget. The MoF is responsible for disbursing funds to the Iraqi Ministries and provincial treasuries.
- 1.2.8 Disbursements made by the CPA on behalf of the Iraqi Ministries were subject to prior approval by Contracting Officers or other CPA officials.
- 1.2.9 Prior to disbursing funds to the MoF, final approval was required by the CPA Administrator.

1.3 Findings

- 1.3.1 The results of testwork of the above controls are documented in sections 2 and 6.

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2 Authorization by the CPA of disbursements to Iraqi Ministries

2.1 Procedure

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

2.2 Findings

2.2.1 Iraqi Ministries were partly funded by the DFI and partly by other sources. We were informed by the CPA and the MoF that significant additional funds from other sources were transferred from the CPA to the MoF prior to October 2003. The CPA informed us that these additional transfers from other sources related to funds from the former Iraqi regime, frozen in the United States of America (US) under UNSCR 687 and subsequently vested under Executive Order 13290 of 20 March 2003, monies seized in Iraq under the laws and usages of war and US Appropriated Funds.

2.2.2 The CPA distributed DFI funds directly to the MoF in accordance with the monthly funding requirements agreed between the CPA and the MoF. Thereafter, DFI funds were re-distributed by the MoF to other Iraqi Ministries in accordance with their individual operating budgets. We agreed the following disbursements made from the DFI to the MoF manual accounting records during the period from 22 May to 31 December 2003 as follows:

October 2003	\$ 433,000,000
November 2003	392,950,000
December 2003	<u>550,000,000</u>
	<u>\$ 1,375,950,000</u>

2.2.3 We also agreed these disbursements (five in total) to the MoF bank account, denominated in US dollars, at the Central Bank of Iraq. The disbursements were authorized by the CPA Comptroller and the CPA Chief of Staff. We requested, but were not provided with supporting authorization from the CPA Administrator. However, we noted the 2003 Iraqi operating budget was approved by the CPA Administrator.

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2.2.4 Although we were able to agree the amounts transferred from the DFI to the MoF bank accounts and accounting records, we were unable to agree funds transferred by the MoF to funds received by the two Iraqi Ministries visited (Ministries of Health and Transport) because of a number of issues in the internal control systems at the Iraqi Ministries as follows:

- The MoF maintained two sets of accounting records, manual records for the transactions post-hostilities and computerized records representing the continuation of the official records. Reconciliation between these two sets of accounting records was not prepared and the difference was significant.
- We noted that reconciliations between amounts transferred from the MoF and amounts received by the Iraqi Ministries visited were not prepared.
- We noted that the two MoF bank accounts, denominated in US dollars and Iraqi Dinar, at the CBI, and the main accounts at Al-Rasheed and Al-Rafidain banks, were not reconciled to the accounting records and the differences were significant.
- Official computerized accounting records were not maintained by the Ministry of Health, except for manual listings used to update the trial balance. The amount as stated in the manual listing of disbursements was lower than the final trial balance by approximately \$2,500,000 (Iraqi Dinar 3,676,673,905). An explanation was requested but not provided for the difference. Furthermore, we found a number of incorrect postings and manual corrections of numbers posted in the manual listings of expenses.
- Salary costs for April, May and June 2003 were not recorded in the accounting records of the Iraqi Ministries as payments were made directly to employees by the MoF.
- We noted one case when a receipt was recorded twice by different employees of the MoF.
- We were informed by the Ministry of Health that MoF receipts were not always recorded in their accounting records due to amounts being paid directly by the MoF to directorates and hospitals without the Accounting Department being informed.
- We were informed by the Iraqi Ministries visited that cash disbursements from non-DFI funds were made directly by the CPA to a number of departments of Iraqi Ministries, bypassing the Accounting Departments of the related Iraqi Ministries and the MoF without being informed.
- Ministries of Health and Transport did not have computerized records as computers had been looted post hostilities.

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

3.1 Procedure

We documented key internal controls surrounding the monitoring process implemented by the CPA over disbursements made by the Iraqi Ministries.

3.2 Key internal controls

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

3.2.2 Disbursements for salaries were to be made in accordance with CPA Order 30 dated 8 September 2003, as supplemented by monthly instructions issued by the CPA and the MoF. Any action causing the increase of more than 1% in the payroll of a Ministry workforce over the previous month was to be approved by the CPA Senior Advisor to the MoF.

3.2.3 CPA Advisors to the Iraqi Ministries were to authorize monthly payroll summaries prior to disbursement of funds.

3.2.4 Major capital expenditures were to be monitored by the CPA Contracting Unit.

3.2.5 The CPA also stated that they mainly relied on the internal controls established at the Iraqi Ministries, including the work performed by the internal auditors of the MoF and the Iraq Board of Supreme Audit (BSA), to ensure funds disbursed to Iraqi Ministries were utilized as budgeted.

3.3 Findings

Our findings are noted in sections 5 and 6 below.

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4 Key internal controls at Iraqi Ministries over disbursements

4.1 Procedure

We visited management and individual Inspector Generals of three Iraqi Ministries (Finance, Health and Transport) and documented key internal controls, designed to ensure disbursements of resources from the DFI were utilized as intended.

4.2 Key internal controls

4.2.1 The MoF was responsible for re-distributing DFI funds to Iraqi Ministries and provincial treasuries in accordance with their monthly individual operating budgets. Excess expenditure over the monthly individual operating budgets was subject to authorization by the MoF.

4.2.2 Each Iraqi Ministry and provincial treasury were to be required to prepare a monthly cash-based report detailing disbursements. This report was to be returned to the MoF for review, on a monthly basis with the refund of excess cash not utilized for salaries.

4.2.3 Disbursements for salaries were to be made in accordance with CPA Order 30 dated 8 September 2003 as supplemented by monthly instructions issued by the CPA and the MoF. Any action causing the increase of more than 1% in the payroll of a Ministry workforce over the previous month was to be approved by the CPA Senior Advisor to the MoF.

Each Iraqi Ministry consists of a number of departments (e.g. accounting, administration, legal, internal audit, inspection). For each department, monthly payroll sheets were to be prepared, checked by the Internal Audit Department and approved by the head of department.

Approved monthly payroll sheets were to be forwarded to the Finance Department of the Ministry for approval of payroll details (including names, numbers and grades). The Finance Department would then prepare an overall payroll sheet for the entire ministry and forward the listing to the appropriate CPA Advisor for approval.

After the payroll sheet was approved by the CPA Advisor, the MoF authorized the monthly payroll summary prior to disbursement of funds.

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

4.2.4 Disbursements for goods and services require different levels of authorization according to value. For requests in excess of Iraqi Dinar 5,000,000 (\$3,300) a tender process was to be undertaken, whereby three bids were to be received and the successful bidder was to be approved by an Award Committee and authorized by the Deputy Minister and Minister.

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4.2.5 Individual Iraqi Ministries and provincial treasuries were subject to audits by the audit function of the MoF (over 60 auditors) and the BSA (over 800 auditors).

4.3 Findings

4.3.1 For disbursements to provincial treasuries, we found that 25 out of 102 monthly cash-based reports had not been submitted to the MoF due to security issues. For disbursements to the two Iraqi Ministries visited, we noted the excess cash not utilized for expenses other than salaries was not returned to the MoF as the cash is automatically rolled into the subsequent month's operating budget.

4.3.2 We found that Iraqi Ministries did not maintain separate accounting evidence or separate bank accounts for DFI and non-DFI funds.

4.3.3 Additional findings are noted in section 5 below.

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5 Procedures undertaken over disbursements made directly by Iraqi Ministries

5.1 Procedures

For a sample of disbursements for each of the MoF and two Iraqi Ministries visited to date, we performed the following procedures:

- 5.1.1 Determined whether the key internal controls, noted in section 4.2.4, for approving, bidding and awarding of contracts to which disbursements relate were being followed;
- 5.1.2 Compared payroll details for each employee to the accounting records and personnel file;
- 5.1.3 Observed whether the contract and purchase invoice were signed and approved by an authorized person in accordance with the CPA's and the Iraqi Ministries' policies and procedures; and
- 5.1.4 Compared expenditure to goods received notes or other supporting documentation evidencing services rendered.

5.2 Findings

- 5.2.1 Our work at the Iraqi Ministries is currently in progress and findings detailed below are only in respect of work performed to 29 June 2004 for the period to 31 December 2003. We were able to complete work at three Iraqi Ministries (the MoF, Health and Transport) and work at two other Iraqi Ministries (Oil, and Housing and Construction) is in progress. Additional findings, if any, will be included in our report for the second period to 30 June 2004.
- 5.2.2 We were informed by the CPA that more than 1.2 million employees are paid through the Iraqi budget. The Iraqi Ministry of Education employs a large number of state employees. We were denied access to this Ministry pending approval by the new Iraqi Government. Other problems encountered include limited working hours at Iraqi Ministries and limited resources due to security issues.
- 5.2.3 We requested but were not provided with tender documents from the Ministry of Health. We found that a purchase of weapons by the MoF was made without tendering procedures, as also noted by the MoF internal audit manager. For our sample at the Ministry of Transport, we did not find any exceptions. Our sample covered 32% (by value) of expenses other than salaries at the three Iraqi Ministries visited.

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5.2.4 The MoF informed us that disbursements made by Iraqi Ministries during the period to 31 December 2003 were principally for salaries and other salary costs. According to the manual accounting records, disbursements made by the three Iraqi Ministries visited for the period from post-hostilities to 31 December 2003 from all sources of funds are summarized as follows (in millions of Iraqi Dinar):

<i>Description</i>	<i>Finance</i>	<i>Health</i>	<i>Transport</i>
Salaries	33,140	31,947	23,810
Retirement cost	40,000	-	-
Capital expenditures	415	18,190	970
Maintenance costs	379	9,015	63
Unreconciled difference (see 2.2.4)	-	3,677	-
Other	<u>1,964</u>	<u>6,558</u>	<u>244</u>
	ID <u>75.898</u>	<u>69.387</u>	<u>25.087</u>
US dollar equivalent (ID 1,500/ \$1) (in thousands of US dollars)	\$ <u>50.599</u>	\$ <u>46.258</u>	\$ <u>16.725</u>

5.2.5 From our sample (15 employees for each of three months) we were not able to obtain evidence to verify staff grades for five employees at the Ministry of Health. For other employees at the three Iraqi Ministries, we observed payments were in accordance with accounting records and personnel files.

5.2.6 In addition, BSA audit reports included the following findings related to salaries:

- Employee names are repeated and disbursements are duplicated;
- Salaries are received by members of staff on behalf of other employees without written authorization;
- Retired employees received payments from their original department and the Retirement Department, duplicating disbursements;
- The number of employees in the Finance Department sheets supporting the Emergency Payment to all state employees (\$30) differed from the number in the Accounting Department; and
- Employee grades were upgraded without justification being authorized by administrative orders.

5.2.7 For our sample of disbursements from the MoF and the two Iraqi Ministries visited, we found that all contracts and purchase invoices were signed and approved by an authorized person, except for the Ministry of Health. We found 9 payments amounting to approximately \$2,300,000 made by the Ministry of Health were supported only by a letter from the CPA Advisor to the Ministry of Health. To date, additional supporting documentation has not been provided to us.

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5.2.8 For our sample of disbursements from the MoF and the two Iraqi Ministries, we found adequate supporting documentation for goods received or evidencing services rendered, except for the Ministry of Health (section 5.2.7).

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6 Testing of disbursements made on behalf of Iraqi Ministries

6.1 Procedures

For a sample of 98% (by value) of disbursements made by the CPA on behalf of the Iraqi Ministries, we performed the following procedures:

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

6.2 Findings

- 6.2.1 Based on funding plans, DFI payments made on behalf of the Iraqi Ministries to 31 December 2003 were as follows:

<i>Ministry of:</i>	<i>Project:</i>	
Finance	Iraqi banknote purchase	\$ 116,592,500
Finance	Iraqi banknote exchange	31,154,245
Finance	Iraqi currency exchange	340,000
Finance	OFF – Northern program	13,461,800
Finance	Trade Bank of Iraq	1,100,000
Oil	Import of petroleum products	13,417,109
Oil	Security	12,559,809
Oil	Restoration of oil infrastructure	1,130,000
Oil	Communications	315,492
Electricity	Purchase of electricity from Turkey	11,392,602
Electricity	Reconstruction of power plants	4,919,055
Electricity	Restoration of Iraqi electricity	4,100,000
National Security and Defense	Weapons	2,832,000
National Security and Defense	Equipment	1,277,748
Trade	OFF – Co-ordination centers	25,000,000
Awqaf (Religion)	Hajj pilgrimage	5,000,000
Housing and Construction	Security	569,320
Culture	Donation	20,000
		<u>\$ 245,181,680</u>

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6.2.2 We found that the key internal controls, noted in section 1.2 above, for approving, bidding on, and awarding of contracts to which the disbursement related were not always followed. Our sample comprised 14 funding plans (programs), which included 21 contracts out of 44 contracts or 98% of the total value (section 6.2.1).

Approval deviations noted

- We found ten cases where programs funded by the DFI were recommended for approval with less than 70% of voting members present during six separate PRB meetings.
- We found one case when a contract was awarded prior to program recommendation by the PRB and approval by the CPA Administrator.
- We found one case when a program was delayed pending further justification during a PRB meeting, but subsequently recommended for approval out-of-session by the board members without approval being documented in subsequent PRB minutes.
- We found two cases when programs were recommended for approval by the PRB and approved by the CPA Administrator without clarifying the source of funding in the PRB minutes.

Contracting deviations noted

- We found one case when the Technical Committee did not properly consider key elements of program requirements. Subsequent to award, the contract was amended, including the key elements and additional costs. In addition, these key requirements were not tendered on the grounds of urgency. Furthermore, documentation for background checks on the financial resources of the contractor was limited to only a credit check.
- We found six cases when the required written documentation, justifying the award of contracts without competition was not available.

Post award deviations noted

- In three cases disbursements on programs exceeded allocated amounts authorized by the CPA Administrator.

6.2.3 For our sample of disbursements made on behalf of the Iraqi Ministries we found that all contracts and purchase invoices were signed and approved by an authorized person in accordance with the CPA's policies and procedures subject to the exceptions noted below.

6.2.4 For our sample of disbursements made on behalf of the Iraqi Ministries we found that in two cases, supporting documentation was not available in the contract file to justify progress disbursements based on performance of contractual obligations. For all other expenditure, we observed adequate supporting documentation for goods received or evidencing services rendered.

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Appendix
Procedures

To assist the International Advisory and Monitoring Board and the CPA in determining whether the disbursement of resources from the DFI is in accordance with the provision of UNSCR 1483 paragraph 14 and that DFI funds are used in transparent manner and for the purposes for which they were disbursed, you have requested us to perform the following procedures:

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

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6. For a sample (scope: to be determined at a future stage) of disbursements made on behalf of the Iraqi Ministries, perform the following work:
 - Determine whether the key internal controls, for approving, bidding and awarding of contracts to which disbursements related to were being followed;
 - Determine whether the internal control procedures documented above, for the bidding on and awarding of contracts were followed,
 - Observe that contracts and purchase invoices are signed and approved by an authorized person in accordance with the CPA's and the Iraqi Ministries' policies and procedures,
 - Compare expenditures to goods received notes or supporting documentation evidencing services received.