



REVENUE WATCH

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Audit Finds More Irregularities and Mismanagement of Iraq's Revenues

The latest audits by the International Advisory and Monitoring Board for Iraq (IAMB) and the Coalition Provisional Authority Inspector General (CPA-IG) reveal hundreds of irregularities in the U.S.-led occupation authority's management of Iraqi revenues, and identify serious weaknesses in Iraq's financial management systems.

IAMB auditors discovered a wide range of irregularities, including the lack of competitive bidding for large contracts, missing contract information, payments for contracts that had not been supervised, and, in some cases, outright theft.¹ The absence of metering equipment, the audit also states, made it impossible to estimate the amounts of petroleum and petroleum products illegally exported in the first half of 2004.

In its report to Congress, the CPA-IG noted numerous deviations from legal obligations and federal contracting norms in the CPA's management of Iraqi revenues during the occupation. A new problem identified by the audit is the lack of transparency of Iraqi funds since the transfer of power to the Iraq Interim Government (IIG).

As shown by these audits and others, the legacy of CPA accounting practices is a poor model for present and future Iraqi governments. It represents a failure to demonstrate by example the importance of transparent and responsible management and expenditure of public revenues.

IAMB Finds Further Evidence of Mismanagement

In its second audit of the Development Fund for Iraq during the final half year of occupation (January 1, 2004–June 28, 2004), the International Advisory and Monitoring Board has uncovered further evidence of sloppy management of Iraqi revenues by the U.S.-led Coalition Provisional Authority and by Iraqi ministries.

In this report, published in September 2004, the auditors note that as in their previous audit, investigators encountered difficulties in accessing information from the Iraqi ministries and were denied access to the Kurdish Regional Government’s accounting records altogether. Nevertheless, in their audit of disbursements made by Iraqi ministries, and by the CPA on behalf of the ministries, the auditors found hundreds of deviations from required practices. The disbursements in question were valued at over \$4 billion.²

One such irregularity involved a case in which the CPA granted a no-bid contract worth more than \$339 million, providing no justification or documentation.³

The auditors noted that the dismal information management systems and limited computerization in the Iraqi ministries magnified the likelihood of human error and poor reconciliation of accounts. Inadequate training exacerbated the problems. The Ministry of Finance’s policy manual on accounting procedures, for example, was not widely distributed to staff and there was little formal training.⁴ A new Financial Management Information System, to be implemented in 2005, may help in addressing these control weaknesses.

The audit also revealed that steps to monitor and control oil smuggling had not been taken before the handover of power. The absence of metering equipment, which makes it impossible to estimate how much crude oil is being smuggled, is a well-known problem. In its March 2004 meeting, the IAMB pushed for the expeditious installation of metering equipment in line with standard industry practices. When occupation ended in June 2004, metering equipment had still not been installed. As a result, the Coalition Provisional Authority admitted that it was “unable to reliably estimate the amounts of petroleum and petroleum products that were illegally exported for the period from 1 January to 28 June 2004.”⁵

Moreover, not all proceeds from oil sales were deposited into the Development Fund for Iraq, as required by UN Resolution 1483. Cash advances for oil sales during this period, amounting to over \$20 million, were deposited into an Iraqi Bank account of the State Oil Marketing Organization, instead of going to the DFI.

A long-standing conflict between the IAMB and the U.S. government over access to information necessary to audit sole-source contracts paid by Iraqi funds seems to have been resolved. According to the IAMB’s September 2004 audit report, Deputy Under-Secretary of Defense David Norquist, who serves as an observer to the IAMB, proposed having the U.S. government commission the audit, with terms of reference to be decided by the IAMB.⁶ The expected completion date for the audit, however, was not specified. Seventy-three percent of the value of contracts worth over \$5 million and paid for with DFI funds were not competitively bid.⁷

The interim government of Iraq is responsible for selecting an audit firm to review oil export sales and DFI operations from the time it assumed sovereignty on June 29, 2004, as required by UN Security Council Resolution 1546.

CPA-IG Audit Reports Highlight Need for Greater Scrutiny

The Coalition Provisional Authority Inspector General's third report to Congress since its inception was considerably thinner than past reports. Under its authorizing legislation, the CPA-IG was to be dissolved by December 28, 2004, six months after the CPA ceased to exist. Legislation recently passed by Congress and now awaiting the president's approval would extend the CPA-IG's operations until October 2006.

Months of organizational uncertainty, however, have reduced the CPA-IG's effectiveness. Many of its staff, on loan from other agencies, returned to their home offices, and recruiting new staff has become increasingly difficult. During the period of this audit, the CPA-IG's staff declined by 42 percent.⁸

As a result, many of the audits scheduled to be completed by this time are still underway. Others have been cancelled. The cancellations included the following:

- ▶ An assessment of the timeline for spending the \$18.4 billion Iraq Relief and Reconstruction Fund. The U.S. Government has come under heavy criticism for the slow pace at which this Fund is being used. Only 7.1 percent of the Fund has actually been expended more than 13 months after the Fund was approved.⁹ Overall, of the \$24.1 billion in U.S. funds appropriated for Iraq to date, about \$13 billion has been obligated and only \$5.2 billion expended.¹⁰
- ▶ An audit of the tendering process for a \$293 million security contract awarded to Aegis Defense Systems. This contract drew much controversy not only because of the company's lack of experience but also because Tim Spicer, who heads the company, is being investigated by the British government for the sale of arms to Sierra Leone despite a United Nations embargo. The CPA-IG will, however, audit Aegis' compliance with the contract terms.

While the CPA-IG's October 30, 2004 report to Congress had markedly less detail than previous reports, it noted numerous, troubling irregularities in the CPA's management of Iraqi revenues during the occupation. These deviations from legal obligations and federal contracting norms included:

- ▶ A case where approval of funds took place *after* a contract was signed (\$7,050,000).¹¹
- ▶ 34 cases where advance payments totaling more than \$1.5 billion were made from the DFI to the U.S. Army Corps of Engineers to pay primarily for fuel imports and restoration of oil and electricity infrastructure. This is particularly noteworthy because Kellogg, Brown, and Root (KBR) was securing fuel for the Army Corps of Engineers

during the occupation.¹² In December 2003, Pentagon auditors uncovered an overcharge of \$61 million by KBR on a contract to supply fuel for the military in Iraq, and again, in January 2004, KBR repaid \$6.3 million in overcharges and kickbacks for fuel contracts in Kuwait.¹³

- ▶ 37 cases where contracting files could not be located, for contracts totaling more than \$185 million.¹⁴
- ▶ One case where a contract was entered into against the explicit objections of the only Iraqi representative to the spending board (Program Review Board) ¹⁵
- ▶ One case where an advance of almost \$3 million was given by a CPA senior advisor without justification (the contract was later canceled and the advisor left the CPA).¹⁶
- ▶ Several cases where the CPA used DFI funds for purposes explicitly forbidden by statutory laws under occupation.¹⁷
- ▶ A disbursement of \$1.4 billion, in the occupation's final days, to the Iraqi Ministry of Finance under the budget line item "transfer payments." The auditors were "unable to obtain further analysis or information regarding the intended utilization of this budget line item."¹⁸
- ▶ 111 cases where reports or other supporting documentation describing services received for contracts signed and payments made could not be found, for work totaling more than \$19 million.

In addition to its October 30, 2004 report to Congress, the CPA-IG completed two audits in this reporting period, with ten additional audits still underway. The audit of the CPA's accountability controls over Iraqi-appropriated funds resulted in a satisfactory review.¹⁹ A second audit of KBR's control of materiel assets in Kuwait was more problematic.

As part of its contract to provide logistics and support services to U.S. troops in Iraq, KBR was responsible for managing 3,032 task-related items of U.S. government property in Kuwait valued at more than \$3.7 million.²⁰ The audit report found that KBR was unable to account for nearly half (42.8 percent) of the property it managed in Kuwait. The auditor's report noted that "we projected that property valued at more than \$1.1 million was not accurately accounted for or was missing."²¹ The CPA-IG recommended that corrective action be taken to improve KBR's property control system, and that the Defense Contract Management Agency (DCMA), which oversees KBR's work on this contract, initiate appropriate recovery actions against KBR. Although the DCMA came to the company's defense in its response, the CPA-IG disputed their arguments, emphasizing that the DCMA should take corrective action to protect government property from potential waste, fraud, and abuse.

While this audit evidences waste and negligence involving U.S. tax dollars and not Iraqi revenues, KBR has also received more than \$921 million from the Development Fund for Iraq under separate contracts.²² The integrity of KBR's management practices is thus of particular concern to the Iraqi government and people, and is significantly in question due to this and other reports and investigations.²³

A further problem highlighted by the CPA-IG is the utter lack of transparency over Iraqi funds since the transfer of power to the Iraqi Interim Government (IIG) on June 28, 2004. UN Security Council Resolution 1546 required that under the interim government, "the Development Fund for Iraq shall be utilized in a transparent and equitable manner and through the Iraqi budget."²⁴ Nevertheless, since the transfer, Iraq Revenue Watch has been unable to find any public reporting about the DFI. The CPA-IG similarly reports that "since the transfer of sovereignty to the IIG . . . total deposits to the DFI can only be estimated, because CPA-IG does not have access to information on the status of DFI funds now under IIG control."²⁵ The Inspector General estimates, however, that since June 28, 2004 the IIG has realized \$4.58 billion in oil revenues, of which five percent (\$228.8 million) had to be transferred to a compensation fund for Kuwait.

With the passage of the National Defense Authorization Act of 2005 (H.R. 4200) in October 2004, the future of the CPA-IG is now more assured. H.R. 4200 includes a provision authorizing the agency to continue operating until 10 months after 80 percent of the Iraq Relief and Reconstruction Fund (IRRF) has been obligated.²⁶ Based on the CPA-IG's projections, this will happen by December 2005, which means that the Inspector General's office would operate until October 2006.²⁷

While the extension of the CPA-IG's mandate is a welcome and necessary development, there are two main concerns about the terms under which H.R. 4200 will extend the agency's tenure.

First, the special inspector would have 10 months to close down operations after 80 percent of funds in the \$18.4 billion IRRF have been "obligated," not "expended."²⁸ This leaves open the possibility that obligated funds could be reprogrammed and ultimately spent on alternative projects and contracts other than those subjected to the CPA-IG's scrutiny. The U.S. has already reprogrammed funds obligated for sectors of Iraq's reconstruction, such as electricity and water systems, to pay for unanticipated security needs.²⁹ Hence, it would make greater sense to extend the CPA-IG mandate until all funds have been expended.

Second, H.R. 4200 grants the special inspector 10 months after only 80 percent of funds have been obligated, leaving no mechanism in place for the inspector to scrutinize the remaining 20 percent of U.S. reconstruction funds, which amount to more than \$3 billion in U.S. taxpayer dollars.

The decision on extending the CPA-IG's mandate now awaits presidential action.

Notes

1 The IAMB report notes that the independent auditor, KPMG, was informed by the CPA Comptroller of one case where \$774,300 was stolen from a division's vault, and a police investigation is ongoing. See "Development Fund for Iraq: Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004," KPMG Bahrain, September 2004, p 23, <http://news.findlaw.com/hdocs/docs/iraq/cpa101304audit.pdf>.

2 Iraq Revenue Watch calculation based on data reported in "Development Fund for Iraq: Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004," KPMG Bahrain, September 2004, <http://news.findlaw.com/hdocs/docs/iraq/cpa101304audit.pdf>.

3 *Ibid*, p. 12.

4 *Ibid*, p.10.

5 Development Fund for Iraq: Report of Factual Findings in connection with Export Sales for the period from 1 January 2004 to 28 June 2004. KPMG Bahrain, September 2004, <http://www.iamb.info/auditrep/OilProc101204.pdf>.

6 *Ibid*.

7 "Disorder, Negligence, and Mismanagement: How the CPA Handled Iraq Reconstruction Funds," Iraq Revenue Watch Report No. 7, September 2004. <http://www.iraqrevenuewatch.org/reports/092404.pdf>.

8 Message from the Inspector General, Coalition Provisional Authority, October 30, 2004, http://www.cpa-ig.com/pdf/cpaig_october_30_report.pdf.

9 Office of Inspector General Coalition Provisional Authority, *Third Quarterly Report to Congress*, October 30, 2004, Appendix J, DoD Status Report on Iraq, http://www.cpa-ig.com/pdf/oct_appendix_j.pdf.

10 Office of Inspector General Coalition Provisional Authority, *Third Quarterly Report to Congress*, October 30, 2004, p. 4, <http://www.cpa-ig.com/oct.html>.

11 *Ibid*, p. 18.

12 *Ibid*, p. 18.

13 For more information, see T. Christian Miller, *Halliburton Contracts Bypassed Objections*, Los Angeles Times, October 29, 2004 and Joanne Morrison, *Whistleblower Says Halliburton Contract Abuse Blatant*, Reuters, October 29, 2004.

14 *Development Fund for Iraq, Report of Factual Findings in Connection with Disbursements for the period from 1 January 2004 to 28 June 2004*. KPMG Bahrain, September 2004. p. 18.

15 *Ibid*, p. 19.

16 *Ibid*.

17 *Ibid*, p. 21.

18 *Ibid*, p. 6.

19 *Coalition Provisional Authority Control of Appropriated Funds*, Report Number 05-001, Coalition Provisional Authority Inspector General, October 22, 2004.

http://www.cpa-ig.com/pdf/cpa-ig_audit-cpa_control_of_appropriated_funds.pdf.

20 *Accountability and Control of Materiel Assets of the Coalition Provisional Authority in Kuwait*, Report Number 05-002, Coalition Provisional Authority Inspector General, October 25, 2004,

http://www.cpa-ig.com/pdf/cpaig_audit-control_materiel_assets_kuwait.pdf.

21 *Ibid*.

22 See the CPA-IG's table of verified contracts on its website at http://www.cpa-ig.com/pdf/table_j_1_verified_contracts_updated.pdf.

23 For more information, see the Center for Public Integrity, *Windfalls of War: Kellogg, Brown & Root (Halliburton)*, <http://www.publicintegrity.org/wow/bio.aspx?act=pro&ddlC=31>; David Phinney, *Halliburton Hit with Multiple Lawsuits*, CorpWatch, October 27th, 2004; <http://www.corpwatch.org/article.php?id=11613>; and *Contracts in Iraq probed by FBI*, Associated Press, October 29, 2004.

24 United Nations Security Council Resolution 1546, adopted on June 8, 2004,

http://www.un.org/Docs/sc/unsc_resolutions04.html.

25 Office of Inspector General Coalition Provisional Authority, *Third Quarterly Report to Congress*, October 30, 2004, p. 2, <http://www.cpa-ig.com/oct.html>.

26 *Ibid*.

27 *Ibid*.

28 *Ibid*, p 2

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Iraq Revenue Watch monitors Iraq's oil industry to ensure that it is managed with the highest standards of transparency and that the benefits of national oil wealth flow to the people of Iraq. Iraq Revenue Watch complements existing Open Society Institute initiatives that monitor revenues produced by the extractive industries.

In many parts of the world, the lack of proper stewardship over oil resources has resulted in corruption, the continued impoverishment of populations, and abuses of political power. By prompting governments to tackle these problems early, the Open Society Institute hopes to help Iraq avoid this plight.

The Open Society Institute currently supports a recently launched initiative, Caspian Revenue Watch, which monitors the development of oil production in the Caspian basin. The goal is to promote transparency, accountability, and public oversight in the management of oil and natural gas revenues.

Iraq faces even greater challenges than the Caspian region. If Iraq is to become an open, democratic society it will need to develop transparent accountable institutions for ensuring honest management of oil revenues.

There is an urgent need for Iraq Revenue Watch given the current occupied status of the country. The Coalition Provisional Authority and the Iraqi Governing Council should establish rules that ensure complete transparency regarding Iraqi oil revenues. So doing will foster a stable, democratic Iraq, and will protect the Coalition Provisional Authority from charges of misappropriation during this period of trusteeship over Iraq's reconstruction.

The **Open Society Institute**, a private operating and grantmaking foundation based in New York City, implements a range of initiatives throughout the world to promote open society by shaping government policy and supporting education, media, public health, and human and women's rights, as well as social, legal, and economic reform.

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