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GAO And CPA Continue To Find Numerous Setbacks Affecting Iraq Reconstruction Work

In a recent report on Iraq reconstruction, the Government Accountability Office cited several key challenges affecting the effort to stabilize and rebuild Iraq: the unstable security environment, Iraq's evolving institutional capability to govern and secure the country, the availability and coordination of international assistance, and the need for adequate oversight.

The GAO report found that as of the end of April 2004, approximately $58 billion had been made available for Iraq's reconstruction. GAO noted that of the available funds, the U.S. obligated nearly $8 billion of the available $21 billion in U.S. funds and CPA obligated about $15.5 billion of the nearly $21 billion in available Iraqi funds. These funds, GAO said, were used to support ministry operations and expenses, the restoration of essential services, and humanitarian and other human services. Other countries had pledged nearly $14 billion, GAO said. Although, in December 2003, now-former Coalition Provisional Authority (CPA) had put in place an Iraqi-led process to coordinate reconstruction efforts, the capability to track the total amount of assistance and to identify sectors that are not receiving help is still under development, GAO found.

According to GAO, the coalition considers restoring Iraq's power sector to be critical for reviving the country's economy and supporting its infrastructure. However, GAO found that although some improvements have been made in restoring electricity, electrical service in the country as a whole has failed to show any marked improvement over the postwar levels and has worsened in some areas. GAO noted that contractors have reported "numerous instances of project delays due to difficulties in getting employees and materials safely to project sites." Security concerns continually affect the cost of rebuilding the power sector, with one contractor's security related estimates at nearly 18% of its total costs, GAO said. In addition, GAO found that CPA has "faced a number of challenges in identifying, obtaining, and organizing the human resources required to help stabilize and reconstruct Iraq."

CPA Audit Reports—Recent audits by the CPA Office of Inspector General have also examined concerns about the processes by which reconstruction priorities were established and approved. The CPA audits also reviewed the program, operations, and contracts carried out with these funds, along with the management of personnel assigned to CPA Baghdad.

In line with the GAO report, one of the CPA IG audits reported that CPA did not have an accurate count of civilian personnel assigned to the operations in Baghdad. CPA officials believed that their rosters were 90% to 95% accurate, however, with an estimated 1,196 Government and contractor personnel assigned, there could be more than 100 individuals that are not properly accounted for, CPA audit said.

Another CPA IG audit examined whether the processes for establishing reconstruction priorities provided adequate transparency and coordination in the allocation of donated funds. The audit found that although the process by which the funded projects were assembled and approved for consideration was transparent, there was no process for tracking or coordinating internationally funded process with other CPA reconstruction efforts. Moreover, the audit noted that there was "little guidance provided to Iraq Ministries on maintaining adequate supporting documentation that describe the reconstruction efforts to be funded from donated funds." According to CPA IG, the lack of visibility into the use of donated funds could "reduce confidence of foreign entities to donate further."

To improve transparency, the CPA audit recommended that the CPA's Senior Advisor coordinate with the Ministry of Planning and Development Cooperation and document procedures to identify and track projects to be funded from donated funds, account for donated equipment and material, and submit quarterly updates on the projects' progress. Also, the audit recommended that the Senior Advisor coordinate with CPA's Program Management Office to develop and document a Memorandum of Understanding describing how the offices will share information on reconstruction projects.

GAO report, *Rebuilding Iraq: Resource, Security, Governance, Essential Services, and Oversight Issues* (GAO-04-902R), is available at *http://www.gao.gov/new.items/d04902r.pdf*. For the CPA audit reports, visit *http://www.cpa-ig.com/audit_reports.html*.

✦ **Practitioner's Comment—Iraq Reconstruction: Contracts Using Iraqi Money**—The $58 billion made available or pledged for the reconstruction and relief of Iraq is comprised of three separate "pots" of money: approximately $23 billion in U.S. appropriations, $13.6 billion in pledged grants and loans from the international community, and nearly $21 billion of Iraqi funds.

Prior to the transition to Iraqi sovereignty on June 28, 2004, CPA had been responsible for spending both U.S. and Iraqi funds. This does not mean, however, that the same rules have governed these distinct pots of money. The *sources* of the funds—not the party spending them—have determined the applicable contracting procedures and rules.

Contracts awarded with U.S. funds are governed by U.S. federal procurement laws and regulations. Over the course of the last year, the spending of this money has been the subject of intense scrutiny by auditors, politicians, and the media. See, e.g., Nichols, Feature Comment, "Emerging Issues In Iraq Reconstruction Contracting—Audits, Investigations, And The Transition Of Sovereignty," 46 GC ¶ 185. The contracting environment for spending U.S. funds—understaffed U.S. contracting offices applying complex rules under extraordinary oversight—has protracted the spending of U.S. funds.

The $21 billion Iraqi "pot" of money is comprised primarily of proceeds from oil sales, United Nations' Oil for Food program surplus funds, and other assets. Pursuant to U.N. Security Council Resolution 1483 (May 22, 2003), these monies were placed in the "Development Fund for Iraq" (DFI), held in the U.S. Federal Reserve Bank in New York. According to Resolution 1483, the CPA was to use the DFI funds to finance the Iraqi civilian administration, humanitarian needs, infrastructure repairs, economic reconstruction, and other purposes benefiting the Iraqi people.

Although the CPA was responsible for spending the DFI funds prior to the transition, the resulting contracts were not governed by U.S. procurement rules as a matter of law. Rather, from July 2003 until the June 2004, the CPA administered the DFI in accordance with its *internal* regulations and policies. CPA Regulation No. 3 established a Program Review Board (PRB), comprised of representatives from the Coalition and Iraqi ministries, to review potential reconstruction projects and make contract recommendations to the CPA Administrator for approval. Contracts resulting from that process are governed by the 13 page (plus appendices) CPA Memorandum No. 4, *Contract and Grant Procedures Applicable To Vested and Seized Iraqi Property and The Development Fund For Iraq*, Aug. 19, 2003.

Additionally, until recently, the Iraqi-funded reconstruction contracts have not been subject to the same degree of scrutiny as the U.S.-funded contracts. Resolution 1483 established the International Advisory and Monitoring Board (IAMB) to audit the DFI to ensure the transparent use of DFI funds. However, intense wrangling among the CPA and the members comprising the IAMB—the World Bank, the International Monetary Fund, the U. N., and the Arab Development Fund—kept the IAMB from having substantive meetings for almost nine months. Finally, in March 2004, the IAMB hired KPMG International to audit the DFI expenditures.

Just last month, KPMG issued a preliminary audit report criticizing the CPA's accounting system for the DFI funds, and claiming that the CPA staff has failed to give this audit the attention it deserves. Certain watchdog groups have also scrutinized the CPA's use of sole-source contracts funded by DFI monies, and they have argued that the CPA's increased spending of DFI funds in the weeks leading to the transition of sovereignty was a "last-minute spending spree using Iraq's oil money." See, e.g., *Iraq Fire Sale: CPA Giving Away Oil Revenue Billions Before Transition*, Iraq Revenue Watch Briefing No. 7, June 2004. This circumstance has prompted some members of the House Government Reform Committee to call for a formal investigation. The final KPMG audit report, due to be released this week, is likely to cause additional scrutiny *for both the contracting activities and recipients of DFI-funded contracts*.

As the story of DFI expenditures unfolds, broad allegations will be made and even the best-intentioned officials and contractors may not be immune from scrutiny. As practitioners, it is important to remember which rules apply to which pot of money. The DFI funds were not subject to U.S. laws and regulations—as a matter of law—prior to the transition to sovereignty, and they are not subject to that law now that the DFI is controlled by the interim Iraqi government. DFI-funded reconstruction contracts remain subject to CPA Memorandum No. 4 (revised June 16, 2004), and *new* public contracts awarded by the Iraqi ministries will also be governed by CPA Order No. 87, effective May 16, 2004.

✦ **Note**—The principle author of CPA Order No. 87, Department of Commerce Attorney Kenneth A. Lechter, will present and analyze the Iraqi contracting rules in an upcoming issue of INTERNATIONAL GOVERNMENT CONTRACTOR.

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