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**REBUILDING IRAQ**  
**U.S. MISMANAGEMENT OF IRAQI FUNDS**

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PREPARED FOR

**REP. HENRY A. WAXMAN**

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**EXECUTIVE SUMMARY**

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Between March 19, 2003, when U.S. forces invaded Iraq, and June 28, 2004, when the U.S.-run Coalition Provisional Authority turned power over to the interim Iraqi government, U.S. officials disbursed or obligated over \$19.6 billion in Iraqi funds. The vast majority of these funds were withdrawn from the Development Fund for Iraq, the successor to the U.N. Oil for Food Program, while others came from frozen and seized Iraqi assets. Yet despite the magnitude of the sums involved, there has been little scrutiny of how U.S. officials managed the Iraqi assets entrusted to their care.

At the request of Rep. Henry Waxman, this report examines U.S. management of these Iraqi funds. It is based on a review of over 14,000 pages of financial records and other documents from the Federal Reserve; over 15,000 pages of documents from the Department of Defense; audit reports from the Special Inspector General for Iraq Reconstruction, the Defense Contract Audit Agency, the Government Accountability Office, and other auditors; and interviews with auditors, federal officials involved in the management or disbursement of the Iraqi funds, and Iraqi officials.

The report has three principal findings: (1) unprecedented sums of cash were withdrawn from Iraqi accounts at the Federal Reserve Bank in New York and transferred to U.S. officials at the CPA; (2) CPA officials used virtually no financial controls to account for these enormous cash withdrawals once they arrived in Iraq; and (3) there is evidence of substantial waste, fraud, and abuse in the actual spending and disbursement of the Iraqi funds.

### **Billions in Cash Withdrawals**

The documents from the Federal Reserve indicate that the United States shipped nearly \$12 billion in U.S. currency to Iraq between May 2003 and June 2004, an international currency transfer of unprecedented scale. The cash was drawn from accounts containing revenues from sales of Iraqi oil and frozen and seized assets of the former regime.

Nearly half of the currency shipped into Iraq under U.S. direction — more than \$5 billion — flowed into the country in the final six weeks before control of Iraqi funds was returned to the interim Iraqi government on June 28, 2004. In the week before the transition, CPA officials ordered the urgent delivery of more than \$4 billion in U.S. currency from the Federal Reserve, including one shipment of \$2.4 billion — the largest shipment of cash in the bank's history.

In total, more than 281 million individual bills — including more than 107 million \$100 bills — weighing 363 tons were shipped to Iraq.

## **Lack of Financial Controls**

Once the cash from the Federal Reserve arrived in Iraq and came under the control of U.S. officials at the Coalition Provisional Authority, the cash was spent and disbursed with virtually no appropriate financial controls.

Under the terms of the U.N. resolution creating the Development Fund for Iraq, the fund was to be used “in a transparent manner to meet the humanitarian needs of the Iraqi people ... and for other purposes benefiting the people of Iraq.” But no certified public accounting firm was hired to audit disbursements, and hundreds of millions of dollars in overcharges were withheld from international auditors. According to the Special Inspector General for Iraq Reconstruction, U.S. officials cannot account for the spending of billions of dollars in cash.

An official involved in the spending and disbursement of the Iraqi proceeds described an environment awash in \$100 bills. One contractor received a \$2 million payment in a duffel bag stuffed with shrink-wrapped bundles of currency. Auditors discovered that the key to a vault was kept in an unsecured backpack. They also found that \$774,300 in cash had been stolen from a vault. Cash payments were made from the back of a pickup truck, and cash was stored in unguarded sacks in Iraqi ministry offices. One official was given \$6.75 million in cash and ordered to spend it in one week, before the interim Iraqi government took control of Iraqi funds.

## **Evidence of Waste, Fraud and Abuse**

Because of the lack of proper financial controls, there is no reliable accounting of how the Iraqi funds under U.S. control were spent or disbursed. There is, however, evidence that the expenditure and disbursement of these funds was characterized by significant waste, fraud, and abuse.

Examples of wasteful and potentially corrupt spending include the following:

- The largest single recipient of Iraqi funds is Halliburton, which received \$1.6 billion in Iraqi oil proceeds under a contract to import fuel and repair oil fields. According to DCAA auditors, Halliburton’s overcharges under this contract are more than \$218 million.
- An inexperienced but politically connected security firm, Custer Battles, received over \$11 million in Iraqi funds, including over \$4 million in cash. The company has been barred from receiving federal contracts and faces a False Claims Act lawsuit for multiple fraudulent billings.
- Over \$600 million in cash was shipped from Baghdad to four regions in Iraq to allow commanders flexibility to fund local reconstruction projects. An audit of one of the four regions found more than 80% of the funds

could not be properly accounted for and that over \$7 million in cash was simply missing.

- CPA officials gave over \$8 billion in cash to Iraqi ministries that had no internal or financial controls in place to handle such an influx of funds. The Special Inspector General found significant funds that appeared to be paid to “ghost employees” and billion-dollar discrepancies in some expenditures.

### **Need for Further Investigation**

The findings in this report underscore the need for a comprehensive investigation into how the United States spent and disbursed billions of dollars in Iraqi funds. There is substantial evidence of widespread mismanagement, waste, and corruption in the spending and disbursement of over \$19.6 billion in Iraqi funds during the period of U.S. control. The full extent of the waste, fraud, and abuse will not be known without additional investigation.

## I. BACKGROUND

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On March 20, 2003, President Bush issued an executive order transferring Iraqi assets, held in U.S. banks and frozen since Iraq's invasion of Kuwait, to a U.S. Treasury Special Purpose Account (TSPA) established at the Federal Reserve Bank of New York.<sup>1</sup> Two months later, United Nations Security Council Resolution 1483 established the Development Fund for Iraq (DFI) to hold the proceeds of Iraqi oil sales, Iraqi assets frozen in bank accounts outside of the United States, and \$8.1 billion in funds transferred from the U.N.-administered Oil-for-Food program.<sup>2</sup> Control over these two funds — as well as over cash from the former Iraqi regime seized within Iraq — was given to the U.S.-run Coalition Provisional Authority.

The President's executive order and the subsequent Security Council resolution directed that these funds were to be used by the CPA for the benefit of the Iraqi people. The assets of the former Iraqi government — the “ill-gotten gains of Saddam Hussein and his regime” — was “Iraqi money” that should be returned to the Iraqi people to provide for their “benefit and welfare.”<sup>3</sup> Under the terms of the Security Council resolution, these funds were to be used “in a transparent manner to meet the humanitarian needs of the Iraqi people ... and for other purposes benefiting the people of Iraq.”<sup>4</sup>

On June 10, 2003, CPA Administrator L. Paul Bremer issued Regulation Number 2, which governed the DFI and provided:

[This] Regulation is intended and shall be applied to ensure that the Fund is managed in a transparent manner for and on behalf of the Iraqi people,

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<sup>1</sup> U.S. Department of the Treasury, *Fact Sheet* (Mar. 20, 2003) (online at <http://www.treas.gov/press/releases/docs/sheet.pdf>).

<sup>2</sup> United Nations Security Council, *Resolution 1483* (May 22, 2003) (online at <http://www.un.org/News/dh/iraq/iraq-blue-res-052103en.pdf>); Coalition Provisional Authority, *Development Fund for Iraq Financial Reporting Matrix as of June 28, 2004* (Aug. 3, 2004).

<sup>3</sup> U.S. Department of the Treasury, *Fact Sheet* (Mar. 20, 2003) (online at <http://www.treas.gov/press/releases/docs/sheet.pdf>).

<sup>4</sup> U.N. Security Council Resolution 1483.

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consistent with Resolution 1483, and that all disbursements from the Fund are for purposes benefiting the people of Iraq.<sup>5</sup>

Shortly thereafter, Ambassador Bremer wrote in one of his first directives:

As steward for the Iraqi people, the CPA will manage and spend Iraqi funds, which belong to the Iraqi people, for their benefit ... [T]hey shall be managed in a transparent manner that fully comports with the CPA's obligations under international law, including Resolution 1483.<sup>6</sup>

In order to monitor U.S. actions involving the Iraqi funds, U.N. Security Council Resolution 1483 established the International Advisory and Monitoring Board (IAMB) to ensure that the DFI "is used in a transparent and equitable manner."<sup>7</sup> The IAMB includes representatives from the United Nations, Arab Fund for Economic and Social Development, International Monetary Fund, and World Bank.<sup>8</sup> To fulfill its oversight role, the IAMB was authorized to retain independent public accountants to conduct external audits and monitor the internal controls of the DFI. On April 5, 2004, the IAMB named KPMG as the external auditor.<sup>9</sup>

Congress also established a body to oversee the expenditures of the funds: the Inspector General of the Coalition Provisional Authority.<sup>10</sup> Authority for the CPA Inspector General was to terminate six months after the dissolution of the CPA, which occurred on June 28, 2004. However, Congress amended the original authorization to redesignate the CPA Inspector General as the Special Inspector General for Iraq Reconstruction and to extend the life of the Special Inspector General's authority.<sup>11</sup>

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<sup>5</sup> Coalition Provisional Authority, *Regulation No. 2: Development Fund for Iraq* (June 18, 2004).

<sup>6</sup> Coalition Provisional Authority, *Memorandum No. 4: Contract and Grant Procedures Applicable to Vested and Seized Iraqi Property and the Development Fund for Iraq* (Aug. 19, 2003).

<sup>7</sup> IAMB Press Release, *Establishment of the International Advisory and Monitoring Board: Terms of Reference* (Oct. 24, 2003).

<sup>8</sup> IAMB, *Curriculum Vitae of IAMB Representatives and IAMB Alternate Representatives*, at <http://www.iamb.info>.

<sup>9</sup> IAMB Press Release, *Statement by the International Advisory and Monitoring Board on Iraq* (Apr. 5, 2004).

<sup>10</sup> Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, §3001, Pub. L. No. 108-106.

<sup>11</sup> National Defense Authorization Act for FY 2005, Pub. L. No. 108-375.

As of June 28, 2004, the date that the CPA transferred authority over the DFI to the interim Iraqi government, \$20.7 billion had been deposited into the DFI.<sup>12</sup> During the CPA's control of Iraq, it disbursed \$14 billion in DFI assets and obligated another \$3.1 billion, leaving a \$3.5 billion balance transferred to Iraqi control.<sup>13</sup> In the same period, approximately \$1.9 billion was deposited into the TSPA, of which \$1.7 billion was disbursed in cash shipments to Iraq and \$210 million transferred to the DFI (included in the DFI totals above).<sup>14</sup> Coalition military forces seized \$926.7 million in cash from the former regime, and the CPA obligated or expended \$774.4 million of that amount.<sup>15</sup>

In total, the CPA controlled \$23.3 billion in Iraqi funds and spent or disbursed \$19.6 billion. Of the amount expended, almost two-thirds — more than \$12.7 billion — was disbursed in cash. Figure 1.

**FIGURE 1: Iraqi Funds Under Coalition Provisional Authority Control**

(rounded to thousands)

<b>Deposits</b>	
Development Fund for Iraq:	\$20,706,395,000
Treasury Special Purpose Account:	\$ 1,916,496,000
Seized Iraqi Cash	\$ 926,700,000
<i>(Transfer from TSPA to DFI)</i>	<i>(\$ 208,564,000)</i>
<b>Total Iraqi deposits under U.S. control:</b>	<b>\$23,341,027,000</b>
<b>Withdrawals</b>	
Disbursements from DFI:	\$14,058,659,000
Cash shipped to Iraq from TSPA:	\$ 1,707,931,000
Seized cash disbursed or obligated:	\$ 774,400,000
Commitments from DFI:	\$ 3,104,909,000
<b>Total amount disbursed or obligated by U.S.:</b>	<b>\$19,645,899,000</b>
<b>Balance</b>	
<b>Transferred from CPA to interim Iraqi govt:</b>	<b>\$ 3,695,128,000</b>

<sup>12</sup> Coalition Provisional Authority, *Development Fund for Iraq Financial Reporting Matrix as of June 28, 2004* (Aug. 3, 2004).

<sup>13</sup> *Id.*

<sup>14</sup> Federal Reserve Bank of New York, *Summary: Special Currency Shipments to Iraq*; Letter from Federal Reserve Bank of New York to Minority Staff (Feb. 15, 2005).

<sup>15</sup> Special Inspector General for Iraq Reconstruction, *Quarterly and Semiannual Report to the United States Congress*, 58 (July 30, 2004).



## II. PURPOSE AND METHODOLOGY

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Although Congress has conducted an extensive investigation of mismanagement in the U.N.-administered Oil-for-Food program, holding at least 13 hearings on the subject, Congress has, until now, failed to similarly review the U.S. administration of Iraqi assets and revenues by the CPA.

As part of an effort to conduct such a review, the Committee on Government Reform obtained documents from the Federal Reserve Bank of New York and the Department of Defense. Committee staff reviewed over 14,000 pages of financial records and other documents from the Federal Reserve and over 15,000 pages of documents from the Department of Defense. These documents show that billions of dollars of DFI and TSPA funds were shipped to Iraq in the form of United States currency, for disbursement by the CPA to Iraqi ministries and CPA contractors.

Committee staff reviewed all available audit reports addressing the expenditure of the Iraqi funds. These audit reports included reports from the Special Inspector General for Iraq Reconstruction, the Defense Contract Audit Agency, the U.S. Army Audit Agency, and the Government Accountability Office. Committee staff also reviewed letters issued by KPMG, the audit firm hired by the IAMB, as well as statements and meeting minutes from the IAMB.

Committee staff met with Stuart Bowen, Jr., the Special Inspector General for Iraq Reconstruction (formerly CPA Inspector General), officials from the Army Corps of Engineers, and William Reed, Director of the Defense Contract Audit Agency. The minority staff interviewed Frank Willis, a former senior CPA official, and reviewed reports from other CPA officials. The staff also reviewed records of congressional hearings and published media accounts.

III. FINDINGS

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**A. The Federal Reserve Shipped Nearly \$12 Billion in U.S. Currency to Iraq**

The Federal Reserve shipped \$11,981,531,000 in U.S. currency to Iraq between May 2003 and June 2004, according to documents from the Federal Reserve Bank of New York.<sup>16</sup> The cash was drawn from the DFI and TSPA accounts containing revenues from sales of Iraqi oil and frozen and seized assets of the former regime. The CPA also controlled \$926,700,000 in U.S. currency seized within Iraq, mainly from the vaults of the former regime.<sup>17</sup>

This currency was shipped to Iraq on pallets loaded into C-130 cargo planes. A standard pallet of U.S. currency contains 40 “cashpaks” of 16,000 bills each and weighs 1,500 pounds.<sup>18</sup> In the thirteen months that the United States administered the DFI and TSPA, 484 pallets containing 19,360 cashpaks were shipped from New York to Iraq.<sup>19</sup> These pallets held more than 281 million individual bills, weighing 363 tons.<sup>20</sup> In total, the U.S. shipped to Iraq more than 107 million \$100 bills.<sup>21</sup>

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<sup>16</sup> Federal Reserve Bank of New York, *Summary: Special Currency Shipments to Iraq*; Letter from Federal Reserve Bank of New York to Minority Staff (Feb. 15, 2005).

<sup>17</sup> Special Inspector General for Iraq Reconstruction, *Quarterly and Semiannual Report to the United States Congress*, 58 (July 30, 2004).

<sup>18</sup> Federal Reserve Bank of New York, *Summary: Special Currency Shipments to Iraq*; Letter from Federal Reserve Bank of New York to Minority Staff (Feb. 15, 2005).

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

**PHOTO 1:** A “Cashpak” of \$1.6 million in U.S. currency (16,000 \$100 bills).



According to internal Federal Reserve Bank records, CPA officials who controlled the DFI and TSPA ordered an initial shipment of currency to Iraq in April 2003, comprising \$20,008,000 in \$1, \$5, and \$10 bills.<sup>22</sup> Over the next two months, the shipments became larger: \$179,340,000 in May 2003 and \$465,920,000 in June 2003. Cash shipments from New York into Iraq continued at an average rate of once or twice a month for the rest of the year: \$391,200,000 in July, \$808,200,000 in August, \$400,000,000 in September, \$463,975,000 in October, and \$500,000,000 in November.

The December 12, 2003, shipment was markedly larger — \$1.5 billion — and was described by a Federal Reserve official in an e-mail message as “the largest pay out of U.S. currency in Fed history.”<sup>23</sup>

In 2004, the shipments became more regular. The records show shipments of \$750,400,000 in February, March, and April. As the CPA prepared to transfer

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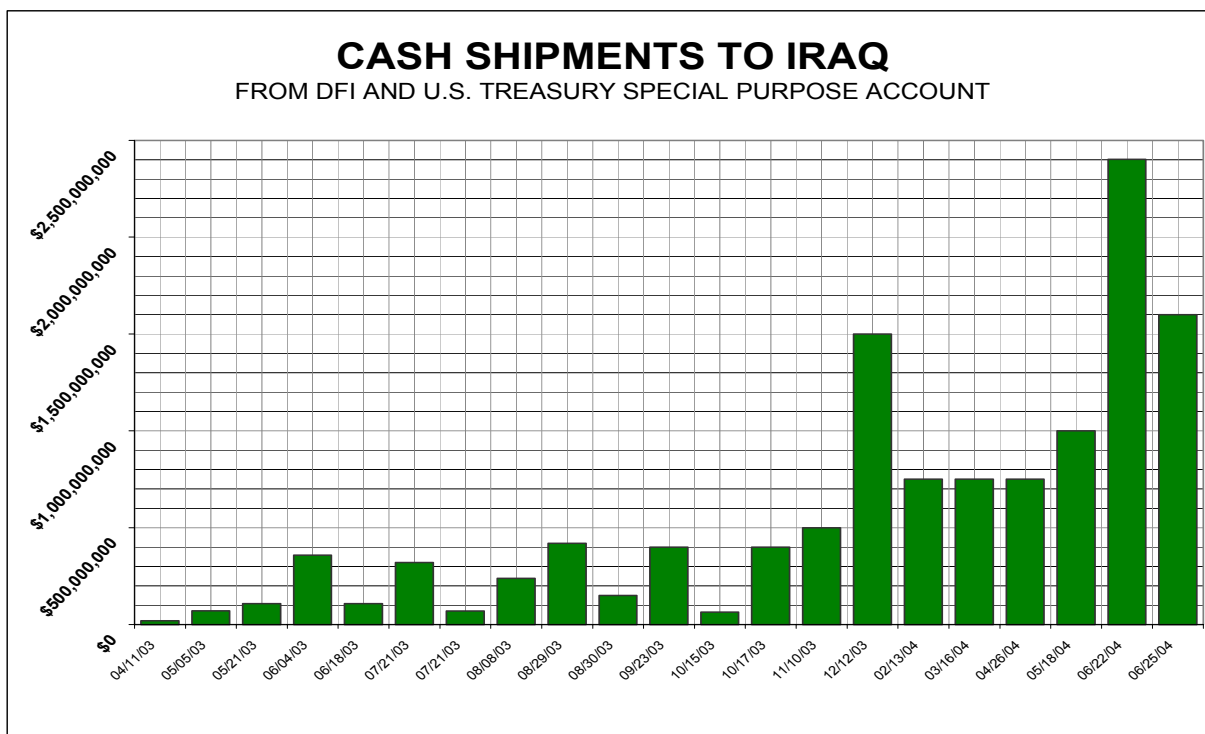
<sup>22</sup> Federal Reserve Bank of New York, *Summary: Special Currency Shipments to Iraq*; Letter from Federal Reserve Bank of New York to Minority Staff (Feb. 15, 2005).

<sup>23</sup> E-mail from Robert Kraus to Joseph Botta (Dec. 12, 2003) (DFI-Cash00220)

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authority to the interim Iraqi government, however, the scale of shipments increased suddenly and sharply: \$1 billion was shipped in May 2004, followed by two massive shipments totaling more than \$4 billion in the week before the transfer of sovereignty.

**FIGURE 2**



In the words of one Federal Reserve official, “Just when you think you’ve seen it all ... the CPA is ordering \$2,401,600,000 in currency to be shipped out on Friday June 18th.”<sup>24</sup> While the Federal Reserve was preparing this shipment, the CPA pushed back the delivery date, and requested an additional shipment:

The new date is 22 June departure with arrival/delivery on 23 June. **It is important that we make these dates as we have little flex. HEADS UP!** We are going to request a second mission for a 28 June delivery.<sup>25</sup>

<sup>24</sup> E-mail from Timothy Fogarty to Dino Kos (June 11, 2004) (FRBNY 003949 DFI-Email).

<sup>25</sup> E-mail from LTC Bill McQuail to Tina Smith, quoting COL Don Davis (June 15, 2004) (DFI-LGL000607) (emphasis in original).

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A Federal Reserve official confirmed the delivery: “I checked the dates with Col Davis and yes, they want delivery to Baghdad on Monday [June 28].”<sup>26</sup> However, a Monday delivery to Baghdad would have required the Federal Reserve to take the unusual step of opening its vaults on a Sunday. The Federal Reserve and CPA sought to avoid that problem:

[T]he CPA is now asking if INSTEAD OF doing the Sunday 6/27 shipment, we can ADD \$1 bn to the already-scheduled Tuesday 6/22 shipment. If that is do-able, it avoids the whole Sunday accounting problem ... but also makes it a **\$3 bn** shipment ... if the USAF [U.S. Air Force] agrees to do it, I would like to give the CPA an answer today on our ability to put another \$1 bn in \$100's on the plane.”<sup>27</sup>

In an e-mail with the subject “RE: Pocket Change,” a CPA official again emphasized the need to push the schedule ahead: “We need to work the second mission as originally planned to arrive on 26th if at all possible. The 27th at latest. I am not sure we can get anything in here from the 28th through the 5 July. We have been ordered to limit travel out of the green zone between 28 June and 5 July. I am just hoping we don't have to back this date up.”<sup>28</sup>

Ultimately, the last-minute cash was sent to Iraq in two separate shipments: \$2,401,600,000 on June 22, 2004, and \$1,600,000,000 on June 25, 2004. The \$2.4 billion delivered on these days replaced the December 2004 shipment as the largest pay out of U.S. currency in Fed history.

In total, nearly \$12 billion in cash flowed into Iraq. Of this amount, nearly half — more than \$5 billion — was shipped into the country in the month before the transition. Figure 3.

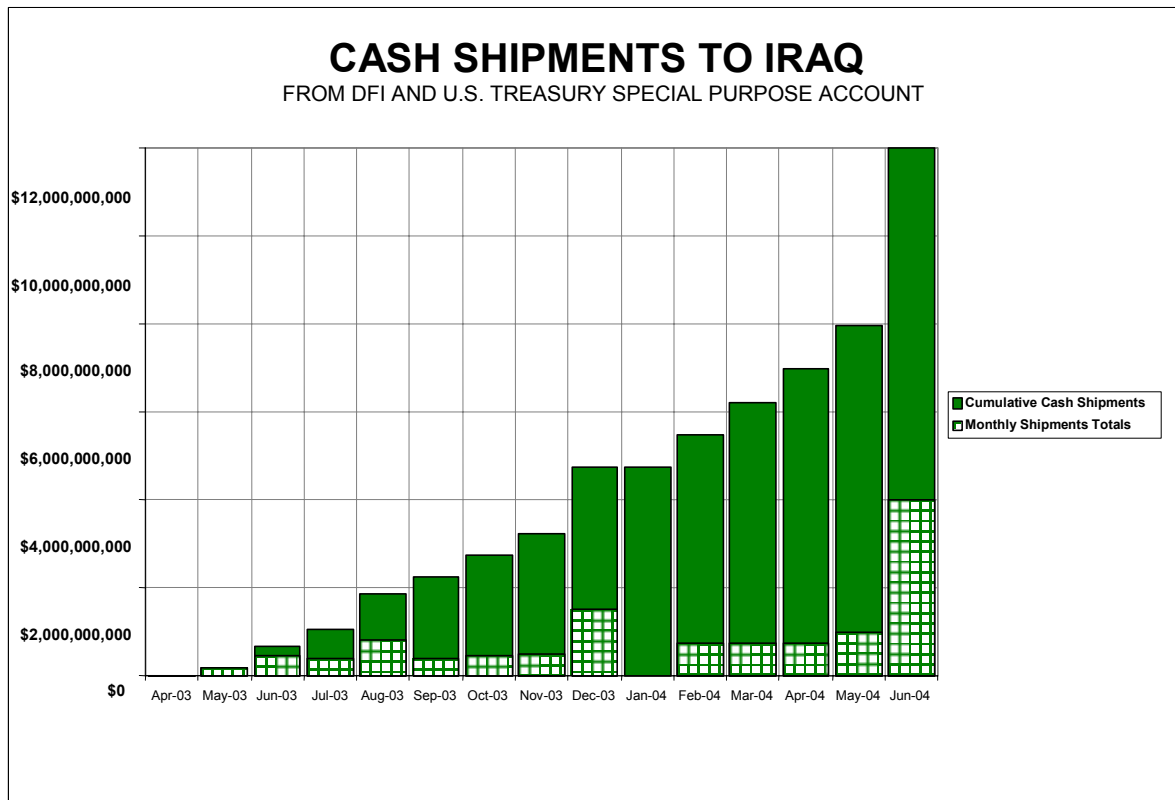
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<sup>26</sup> E-mail from Marybeth Butkus to Timothy Fogarty (June 16, 2004) (DFI-LGL000606).

<sup>27</sup> E-mail from Timothy Fogarty to Felicia Wiggin (June 18, 2004) (FRBNY 003912 DFI-Email) (emphasis in original).

<sup>28</sup> E-mail from COL Don Davis LTC Herman Asberry (June 20, 2004) (DFI-LGL000598)

**FIGURE 3**



The last-minute rush to spend Iraqi funds was halted by the Federal Reserve when the CPA transferred sovereignty to the interim Iraqi government on June 28, 2004, two days earlier than had been scheduled. After the transfer on the morning of June 28, CPA officials twice sought additional withdrawals from the Federal Reserve accounts, but these were rebuffed. The documents show that the Federal Reserve took:

a strong view that effective as of the time AMB Bremer transferred authority (which is being reported in the press as 10:26 am in Baghdad), the CPA no longer had control over Iraq's assets. ... [S]ubsequent to transfer of sovereignty, COL Davis of the CPA sent us \$200 million in payment orders to be executed today in New York. We have informed the Colonel that we are not in a position to honor these instructions. Second, also subsequent to the transfer of sovereignty, COL Davis sent us an instruction to transfer \$800 million from the DFI main account into the new DFI subaccount, which we understand informally was created by AMB Bremer to hold funds that are ear marked internally within Iraq for payments connected to existing contracts. We have also informed COL

Davis that we are not in a position to honor this instruction either (especially since it would require liquidating \$1 billion worth of the CBI's [Central Bank of Iraq] holdings of USG [U.S. Government] securities.<sup>29</sup>

## **B. The CPA Failed to Provide Adequate Financial or Physical Controls**

Once the nearly \$12 billion in cash arrived in Iraq, the cash was placed under the control of U.S. officials at the Coalition Provisional Authority. Contrary to the requirements of the U.N. Security Council resolution and its own regulations, however, the CPA spent and disbursed the cash without appropriate financial or security controls. According to the Special Inspector General for Iraq Reconstruction, the result is that literally billions of dollars cannot be properly accounted for.

In June 2003, the CPA issued a regulation requiring that “an independent, certified public accounting firm” oversee the expenditures of the Iraqi funds. The regulation directed:

The CPA shall obtain the services of an independent, certified public accounting firm to support the objective of ensuring that the Fund is administered and used in a transparent manner for the benefit of the people of Iraq, and is operated consistent with Resolution 1483.<sup>30</sup>

On April 20, 2004, however, CPA officials reported that the “CPA did not obtain the services of a certified public accounting firm as it was determined that these services were not those required.”<sup>31</sup> Instead, the CPA hired an obscure consulting firm called North Star Consultants, Inc., “to promote the effective administration of DFI Funds in a transparent manner for the benefit of the Iraqi people.”<sup>32</sup> The firm is so small that it reportedly operates out of a private home near San Diego.<sup>33</sup>

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<sup>29</sup> E-mail from Michael Silva to Larry McDonald (June 28, 2004) (DFI-CBIAS0000199).

<sup>30</sup> Coalition Provisional Authority, *Regulation Number 2: Development Fund for Iraq* (June 10, 2003).

<sup>31</sup> Email from Greg McCarthy, Coalition Provisional Authority, to Minority Staff, House Government Reform Committee (Apr. 20, 2004).

<sup>32</sup> *Id.*

<sup>33</sup> “*What happened to Iraq’s oil money?*” NBC News (Nov. 30, 2004).

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When the Special Inspector General for Iraq Reconstruction audited North Star's work, the Special Inspector General found that North Star did not perform any review of the CPA's internal controls:

In October 2003 a \$1.4 million contract was awarded to North Star Consultants, Inc. that required the contractor to perform a review of internal controls and provide the CPA a written report of their evaluation. The North Star Consultants did not perform a review of internal controls as required by the contract. Consequently, internal controls over DFI disbursements were not evaluated. In addition, the Comptroller verbally modified the contract and employed the contractor to primarily perform accounting tasks in the Comptroller's office.<sup>34</sup>

The CPA also provided inadequate physical controls to safeguard the billions of dollars of U.S. currency shipped to Iraq, according to the Special Inspector General. In an audit report, the Special Inspector General described "several physical safeguard violations" observed during the audit.<sup>35</sup> In one example, the "CPA Comptroller did not have adequate control or access to their field safe" and "[t]he key was located in an unsecured backpack."<sup>36</sup> In another, "the disbursement officer left the room and lost prevue [sic] over the open safe."<sup>37</sup>

The IAMB found similar problems. One audit by KPMG reported that \$774,300 in cash had been stolen from one division's vault.<sup>38</sup>

Frank Willis, a former CPA official, provided a first-hand account of the vast amounts of cash flowing through Iraq and the lack of financial and physical controls over the funds. During the second half of 2003, Mr. Willis served in Iraq as Deputy Senior Advisor to the Ministry of Transportation and Communications and as the CPA's senior aviation official. Mr. Willis explained that under CPA

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<sup>34</sup> Special Inspector General for Iraq Reconstruction, *Coalition Provisional Authority Comptroller Cash Management Controls Over the Development Fund for Iraq*, Report No. 04-009 (July 28, 2004).

<sup>35</sup> Special Inspector General for Iraq Reconstruction, *Audit Report: Coalition Provisional Authority Comptroller Cash Management Controls Over the Development Fund for Iraq*, Report No. 04-009 (July 28, 2004).

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> KPMG, *Development Fund for Iraq: Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004* at 6.2.13 (Oct. 14, 2004).



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control, a “wild west” atmosphere prevailed and the country was awash in brand new \$100 bills.<sup>39</sup>

According to Mr. Willis, when contractors needed to be paid by the CPA, they were told to “bring a big bag” for a cash payment.<sup>40</sup> Mr. Willis personally witnessed a \$2 million payment to contractor Custer Battles in shrink-wrapped stacks of \$100 bills retrieved from a vault.<sup>41</sup> Photo 2.

**PHOTO 2:** CPA officials standing with \$2 million in cash used to pay Custer Battles.<sup>42</sup>



The Special Inspector General for Iraq Reconstruction reported that cash payments to Iraqi contractors and Iraqi ministries similarly lacked physical security. According to the Special Inspector General, cash payments to

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<sup>39</sup> Testimony of Frank Willis, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, Senate Democratic Policy Committee (Feb. 14, 2005).

<sup>40</sup> Interview of Frank Willis, Committee on Government Reform, Minority Staff (Jan. 27, 2005).

<sup>41</sup> Senate Democratic Policy Committee, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, 109<sup>th</sup> Cong., 24 (Feb. 14, 2005).

<sup>42</sup> Photo provided by Frank Willis

contractors were made from the back of a pickup truck, and cash was stored in unsecured gunnysacks in Iraqi ministry offices.<sup>43</sup>

Controls appeared to break down completely in the final days of CPA authority, just as billions of dollars in cash were being rushed into the country. A Special Inspector General audit found that CPA staff members were encouraged to spend cash quickly in its last days before the interim Iraqi government took control of the funds. In the South-Central region of Iraq, one disbursing official was given \$6.75 million in cash on June 21, 2004, “with the expectation of disbursing the entire amount before the transfer of sovereignty” on June 28, 2004.<sup>44</sup>

The end result is that billions in Iraqi funds spent or disbursed by the CPA cannot be accounted for. The Special Inspector General concluded that “the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner” and that funds were “susceptible to waste, fraud, and abuse.”<sup>45</sup> Although U.N. Security Council Resolution 1483 required that the Iraqi funds be administered “in a transparent manner,” the lack of adequate financial and physical controls have made transparency and accountability virtually impossible.

### **C. There Is Mounting Evidence of Extensive Waste, Fraud, and Abuse**

Due to the lack of proper controls, there is no reliable accounting of how the \$19.6 billion in Iraqi funds was spent and disbursed during the period of U.S. control. There is, however, growing evidence that there was significant waste, fraud, and abuse of these Iraqi funds. Multiple audits of specific expenditures have found mismanagement, wasteful spending, and fraud.

#### **1. Overcharges by Halliburton**

The largest single recipient of DFI funds is Halliburton. Under a no-bid, monopoly contract with the U.S. Army Corps of Engineers, a Halliburton

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<sup>43</sup> *Id.*

<sup>44</sup> Special Inspector General for Iraq Reconstruction, *Control of Cash Provided to South-Central Iraq*, Report No. 05-006 (Apr. 30, 2005).

<sup>45</sup> Special Inspector General for Iraq Reconstruction, *Control of Cash Provided to South-Central Iraq*, Report No. 05-006 (Apr. 30, 2005); Special Inspector General for Iraq Reconstruction, *Oversight of Funds Provided to Iraqi Ministries through the National Budget Process*, Report No. 05-004 (Jan. 30, 2005).

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subsidiary, KBR, was paid approximately \$2.5 billion for the importation of fuel for the Iraqi people, the preparation of oil field damage assessments, and the repair of oil facilities.<sup>46</sup> Of the \$2.5 billion Halliburton received, \$1.6 billion came from Iraqi funds from the DFI.

Halliburton's work in Iraq has been plagued by overcharges. According to audits prepared by the Defense Contract Audit Agency (DCAA), the company's overcharges under the oil contract exceed \$218 million.<sup>47</sup> Of this amount, \$177 million in overcharges were paid from funds in the DFI.<sup>48</sup>

In an audit of just one task order, to import fuel into Iraq from Kuwait, auditors criticized Halliburton's charges in nearly every area, including labor, material, subcontracts, overhead, and general and administrative expenses. The auditors found that these "noncompliances and inadequacies" were "significant" and concluded that "we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price."<sup>49</sup>

DCAA also detailed numerous specific problems with Halliburton's charges. The agency found that Halliburton had failed to demonstrate that its prices for Kuwaiti fuel were "fair and reasonable" and had failed to negotiate better prices with its

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<sup>46</sup> U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Oct. 7, 2004) (online at <http://www.hq.usace.army.mil/CEPA/Iraq/March03-table.htm>).

<sup>47</sup> U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Oct. 7, 2004) (online at <http://www.hq.usace.army.mil/CEPA/Iraq/March03-table.htm>) (calculated using amounts noted under each task order as funded through the DFI, seized Iraqi assets, and U.S. appropriated funds).

<sup>48</sup> *Id.*; Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5 (Audit Report No. 3311-2004K17900055) (Oct. 8, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 6 (Audit Report No. 3311-2004K21000028) (Sept. 16, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 7 (Audit Report No. 3311-2004K21000007) (Sept. 17, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 8 (Audit Report No. 3311-2004K21000008) (Aug. 31, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 9 (Audit Report No. 3311-2004K21000011) (Aug. 30, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 10 (Audit Report No. 3311-2004K21000012) (Aug. 31, 2004).

<sup>49</sup> *Id.* at 5.

Kuwaiti subcontractor.<sup>50</sup> In addition, Halliburton repeatedly refused to provide information requested by DCAA auditors, including its actual costs for fuel from Turkey and Jordan and the process it used to choose its Kuwaiti subcontractor.<sup>51</sup>

Although Security Council Resolution 1483 requires “transparency,” U.S. officials affirmatively sought to withhold information about Halliburton’s overcharges from the IAMB. After failing for months to respond to repeated requests by the IAMB for DCAA’s audits, U.S. officials finally provided the IAMB with “redacted copies of the DCAA audit reports on sole sourced contracts, at its meeting in October 2004.”<sup>52</sup> These audits were so heavily redacted, however, as to be nearly meaningless. Every reference to every overcharge in every audit submitted to the IAMB was blacked out. In total, references to overcharges and other questioned costs were redacted 463 times by Halliburton and U.S. officials.<sup>53</sup>

## 2. Fraud by Custer Battles

In July 2003, a newly formed U.S. security firm with political connections, Custer Battles, was awarded a \$16.8 million sole-source contract to provide security at Baghdad International Airport.<sup>54</sup> In August 2003, the company also received a \$21.3 million contract to provide security for the exchange of Iraqi currency.<sup>55</sup> One of the principals in the company, Michael Battles, was a Republican candidate for Congress in Rhode Island in 2002 with White House ties.<sup>56</sup> In addition to receiving millions of dollars in wire transfer payments from the DFI, Custer Battles also received over \$4 million in cash from the CPA’s vault in Baghdad.<sup>57</sup> According to the minutes of a Program Review Board meeting in

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<sup>50</sup> Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5 (Audit Report No. 3311-2004K17900055) (Oct. 8, 2004).

<sup>51</sup> *Id.*

<sup>52</sup> International Advisory and Monitoring Board, *Report of the International Advisory and Monitoring Board of the Development Fund for Iraq* (Dec. 14, 2004).

<sup>53</sup> Letter from Rep. Henry A. Waxman to Rep. Christopher Shays (Apr. 11, 2005).

<sup>54</sup> Special Inspector General for Iraq Reconstruction, *Quarterly and Semiannual Report to the United States Congress*, K-2 (Jan. 30, 2005).

<sup>55</sup> *Id.*

<sup>56</sup> Griff Witte, *Lawmakers Told About Contract Abuse in Iraq*, Washington Post (Feb. 15, 2005).

<sup>57</sup> Federal Reserve Bank, Iraqi Wire Payments spreadsheet (#77711); Testimony of Alan Grayson, An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq, Senate Democratic Policy Committee (Feb. 14, 2005).

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Baghdad, the decision to award the airport security contract to Custer Battles was made only after “Homeland Security (stateside) agreed with selection of Custer Battle.”<sup>58</sup>

The performance of Custer Battles appears to be rife with waste, fraud, and abuse. In just one example, Custer Battles allegedly seized forklifts from Baghdad airport abandoned by Iraqi Airways, repainted them to cover the Iraqi Airways markings, claimed the forklifts were owned by a Cayman Islands shell company created by Custer Battles, and billed the government to lease the same forklifts under the currency exchange contract.<sup>59</sup>

At a meeting between U.S. officials and Custer and Battles, a Custer Battles representative accidentally left behind a spreadsheet detailing the amounts that Custer Battles had overcharged the government.<sup>60</sup> Government investigators subsequently verified that Custer Battles “fraudulently increased profits by inflating its claimed costs.”<sup>61</sup>

The company has been barred from receiving federal contracts,<sup>62</sup> and it is now facing a federal lawsuit under the False Claims Act.<sup>63</sup>

### 3. Irregularities and Fraud in the Commanders’ Funds

Over \$600 million in Iraqi funds were used by the CPA to establish the Commanders’ Emergency Response Program (CERP) and the Rapid Regional Response Program (RRRP). These programs, which were controlled by military commanders and civilian officials in the field, were designed to fund local and regional reconstruction projects, create local jobs, support local industries, and

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<sup>58</sup> Coalition Provisional Authority, Program Review Board Meeting Minutes (Aug. 5, 2003).

<sup>59</sup> Amended Complaint, *United States ex rel. DRC, Inc. v. Custer Battles, LLC*, CV-04-199-A (E.D. Va. Aug. 26, 2004).

<sup>60</sup> Testimony of Alan Grayson, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, Senate Democratic Policy Committee (Feb. 14, 2005).

<sup>61</sup> Department of the Air Force, *Memorandum in Support of the Suspensions of Custer Battles, LLC et al.* (Sep. 20, 2004).

<sup>62</sup> *Id.*

<sup>63</sup> Testimony of Alan Grayson, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, Senate Democratic Policy Committee (Feb. 14, 2005).

stimulate the economy. In total, the CPA allocated \$637 million in cash from the Iraqi funds to four regions through the CERP and RRRP programs.<sup>64</sup>

The Special Inspector General audited the cash control procedures in one of the four regions — the South-Central Region — that received CERP and RRRP funds. The audit found serious deficiencies that required “prompt attention and separate reporting.”<sup>65</sup> According to the Special Inspector General, “These deficiencies were so significant that we were precluded from accomplishing our stated objectives.”<sup>66</sup>

The South-Central region disbursed \$119.9 million in Iraqi funds. But the Special Inspector General found that the CPA could not account for the expenditure of \$96.6 million — 80% of the funds — and “there was no assurance that fraud, waste, and abuse did not occur in the management and administration of cash assets.”<sup>67</sup> Of the \$96.6 million that could not be accounted for, \$7.2 million in cash remains missing.<sup>68</sup>

Moreover, the Special Inspector General found evidence of fraud and referred cases to the United States Attorney for prosecution. In one of these cases, two agents who were entrusted with cash left Iraq without accounting for their balances of \$777,050 and \$715,000. Rather than report the missing cash, an account manager simply adjusted the accounts to remove the outstanding balances.<sup>69</sup>

#### 4. Irregularities and Corruption in Disbursements to Iraqi Ministries

CPA officials transferred \$10.9 billion in DFI assets to Iraqi ministries. Of this amount, the Special Inspector General tried to audit how \$8.8 billion in cash was expended. The Inspector General reported that these funds were transferred to Iraqi ministries without proper oversight or accounting controls. This large-scale transfer of funds to agencies with no capacity to efficiently administer them

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<sup>64</sup> Special Inspector General for Iraq Reconstruction, Quarterly and Semiannual Report to the United States Congress, 60 (July 30, 2004).

<sup>65</sup> Special Inspector General for Iraq Reconstruction, *Control of Cash Provided to South-Central Iraq*, Report No. 05-006 (Apr. 30, 2005).

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

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violated the CPA's obligations to "ensure DFI funds were used in a transparent manner," according to the Special Inspector General's report.<sup>70</sup>

The Special Inspector General's report found that "proper cash accountability was not maintained, physical security was inadequate, fund agent records were not complete, and fund managers' responsibilities and liabilities were not properly assigned."<sup>71</sup> The report concluded that "the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner" and that "the CPA disbursed over \$8.8 billion in DFI funds to the Iraqi ministries without assurance the monies were properly used or accounted for."<sup>72</sup>

According to the audit report, a large portion of the funds given to the Iraqi ministries were designated for payments of salaries, but the "CPA did not implement adequate controls to ensure DFI funds were properly used for salaries of Iraqi employees."<sup>73</sup> When transferring funds to Iraqi ministries, CPA relied on lists of employees and salaries that were prepared by Iraqi ministries and could not confirm that employees actually worked at the ministries or served useful functions. At one ministry audited, 8,206 guards were on the payroll, although only 602 guards could be validated.<sup>74</sup> The Special Inspector General concluded that "there was no assurance funds were not provided for ghost employees."<sup>75</sup>

Mr. Willis, the former CPA official, corroborated the findings of the Special Inspector General. According to Mr. Willis, the state-run Iraqi Airways, which had not been operational for a year, had 2,400 employees on the payroll, when the airline should have had a staff of 400 or fewer. Mr. Willis said that once the cash was turned over to the ministries, there were no CPA controls on or tracking of the funds: the transfer of cash was "all based on trust."<sup>76</sup> Mr. Willis concluded that in the absence of any accounting system, Iraqi officials skimmed funds as the

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<sup>70</sup> Special Inspector General for Iraq Reconstruction, *Oversight of Funds Provided to Iraqi Ministries through the National Budget Process*, Report No. 05-004 (Jan. 30, 2005).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> Interview of Frank Willis, Committee on Government Reform, Minority Staff (Jan. 27, 2005).

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cash went through the system. In his view, there was “leakage of assets all over the place.”<sup>77</sup>

IAMB audits of DFI funds, conducted by KPMG, identified similar problems. KPMG was “informed that the CPA mainly relied on the internal controls established at the Iraqi Ministries . . . to ensure funds disbursed to Iraqi Ministries were utilized as budgeted.”<sup>78</sup> However, as the Special Inspector General found, “these institutions were not yet functioning and should not have been relied upon to monitor the Iraqi ministries use of funds.”<sup>79</sup>

In a response to the Special Inspector General’s report, Ambassador Bremer argued that the report assumed that “western-style budgeting and accounting standards” could be implemented in the “midst of war.” The Special Inspector General disputed these claims, explaining:

We fully recognize that the CPA operated in a dangerous working environment under difficult conditions. However, the existing administration conditions should have underscored the need for controls over the disbursements to the Iraqi ministries. The CPA should have established controls and provided oversight over the financial management of the DFI funds precisely because there was no functioning Iraqi government, no experience within the Ministry of Finance in managing the national budget, no budget or personnel records, and the payroll systems were corrupted by cronyism and ad hoc fixes.<sup>80</sup>

In another example of questionable distributions for ministry expenses, the Special Inspector General found that “approximately \$1.5 billion in cash allocations were made to Iraqi banks between January and April 2004 for ministry operating expenses, yet spending plans supported only approximately \$498 million in operating expenses.”<sup>81</sup> The Special Inspector General reported that “CPA OMB personnel were unable to provide supporting documentation or

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<sup>77</sup> Testimony of Frank Willis, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, Senate Democratic Policy Committee (Feb. 14, 2005).

<sup>78</sup> KPMG, *Development Fund for Iraq: Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004* at 3.2.1 (Oct. 14, 2004).

<sup>79</sup> Special Inspector General for Iraq Reconstruction, *Oversight of Funds Provided to Iraqi Ministries through the National Budget Process*, Report No. 05-004 (Jan. 30, 2005).

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*



explain significant differences between the spending plans, budget disbursements, and cash allocations.”<sup>82</sup> These discrepancies left over \$1 billion in allocations to Iraqi banks unsupported by ministry spending plans.

### 5. Irregularities in Disbursements to Provincial Governments

The Coalition Provisional Authority also provided funds from the DFI to help local provincial governments conduct their operations. According to KPMG, “[t]he BSA [Iraqi Board of Supreme Audit] reported that total disbursements for the Provincial Treasuries visited during the period amounted to approximately \$1,000,000,000.”<sup>83</sup>

However, the auditors found “no supporting documentation available at Provincial Treasuries for disbursements made by the CPA on behalf of Provincial Treasuries.”<sup>84</sup> In addition, “[n]umerous disbursements to and from the Provincial Treasuries and their divisions were not recorded or incorrectly recorded by either party.”<sup>85</sup>

## IV. CONCLUSION

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After the invasion of Iraq, the U.S.-run Coalition Provisional Authority took control of more than \$22.4 billion in Iraqi resources and spent or disbursed \$19.6 billion. While these Iraqi assets were under U.S. control, unprecedented sums were withdrawn in cash from the Federal Reserve and shipped to Iraq, where they were spent or disbursed by the CPA with virtually no financial controls. Partial audits of these expenditures have disclosed evidence of substantial waste, fraud, and abuse.

Because of the lack of oversight and accounting, the extent of wasteful and corrupt spending during the period of U.S. control is not known. Additional investigation will be needed to provide a complete accounting of what happened to the Iraqi funds and to identify those responsible for excessive and fraudulent expenditures.

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<sup>82</sup> *Id.*

<sup>83</sup> KPMG, *Development Fund for Iraq: Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004*, 5.2.8 (Oct. 14, 2004).

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*