

The seal of the Office of the Special Inspector General for Iraq Reconstruction is a large, circular emblem in the background. It features an eagle with wings spread, perched on a shield with a sunburst and stars. The eagle is surrounded by a wreath. The text "INSPECTOR GENERAL" is written in English and Arabic at the top, and "RECONSTRUCTION" is written in English and Arabic at the bottom.

**FULL IMPACT OF DEPARTMENT OF
DEFENSE PROGRAM TO RESTART
STATE-OWNED ENTERPRISES
DIFFICULT TO ESTIMATE**

**SIGIR-09-09
JANUARY 30, 2009**



SIGIR

Special Inspector General for IRAQ Reconstruction

January 30, 2009

Full Impact of Department of Defense Program to Restart State-owned Enterprises Difficult to Estimate

Summary of Report: SIGIR-09-009

Why SIGIR Did This Study

In June 2006, the Department of Defense (DoD) established a Task Force in the Office of the Secretary of Defense to focus on efforts to stimulate economic development and employment in Iraq. One of the Task Force's major efforts has been to revitalize Iraqi state-owned enterprises (SOE). These enterprises include factories that were important in Iraq's pre-war economy, employing about 200,000 Iraqis, according to DoD officials. The Task Force has received about \$103 million to revitalize state-owned factories.

SIGIR undertook this audit to determine the baseline data and performance metrics the Task Force used to assess the impact of its program to restart state-owned enterprises, the adequacy of internal control procedures used to mitigate risk and ensure that the funds are used for intended purposes, and future Task Force plans. SIGIR performed work at Task Force locations in Arlington, Virginia and Baghdad, Iraq. We also visited five state-owned enterprises assisted by the Task Force. Security requirements limited the number of SOEs that SIGIR could visit, and the time available at each site.

What SIGIR Recommends

SIGIR recommends that the Task Force (1) establish milestones to ensure that baseline data required to assess the impact of the Fiscal Year (FY) 2008 projects is obtained in a timely manner, (2) obtain copies of invoices to verify the cost of items purchased directly by SOEs, and (3) verify receipt of items before payment is made under contracts awarded by the Joint Contracting Command-Iraq/Afghanistan.

DoD agreed with the report's recommendations. However, DoD was concerned that the report neither reflected the difficult operating environment, the conservative nature of its employment estimates, nor the full measure of DoD's controls over disbursements. SIGIR's report addresses these concerns.

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

What SIGIR Found

Task Force efforts have served to help restart state-owned enterprises and provide employment in a difficult security environment. However, the full measure of the Task Force's impact is difficult to estimate because of the absence of good baseline data and weaknesses in the methodology used to identify the number of jobs impacted by the effort. Task Force officials cited two primary reasons why reliable baseline data could not be obtained. First, security considerations limited the time available to tour factories and identify potential projects that could improve operations. Second, assessment teams had to rely on testimonial evidence on the status of production and number of employees working. Absent reliable data, the task force developed an alternate methodology that estimated a 24,500 jobs impact. Impact was defined as returning people to work that were already on an SOE's payroll but not working because a factory was inoperable and/or had limited work for all employees. However, SIGIR was unable to validate the methodology used and does not believe it provides a reliable basis for estimating job impact. In some cases the estimate is based on the total number of employees in a company rather than the number of employees at an individual factory receiving assistance. Going forward, Task Force officials have established performance metrics involving impact on employment, production, and sales, and plans to establish a baseline for these metrics to better assess the impact of the FY 2008 projects.

Additionally, the Task Force has not impacted employment as quickly as initially expected because projects have taken longer to implement than planned. The Task Force anticipated that most of the FY 2007 projects would be implemented within six months. However, only one project was completed within six months and implementation of most projects is now estimated to take more than 13 months from inception.

SIGIR's work identified three areas where internal controls can be improved. First, SIGIR found that although the Task Force verifies that items purchased directly by SOEs are received, it does not obtain copies of invoices to verify the cost of these items. Because about \$18 million (61%) of the funds disbursed as of November 30, 2008 have been transferred electronically or by cash payment directly to SOEs to purchase raw material or equipment, it is important for the Task Force to verify the cost of these items to ensure full accountability of funds. Second, SIGIR found two cases in which the Task Force provided the equivalent of \$229,400 in Iraqi dinars to two SOEs, but has not verified how these funds were used. Third, SIGIR found that items purchased on U.S. contracts are often paid for before verifying receipt of the items by the SOEs. Although SIGIR found that verification of receipt has occurred after the fact, such a practice creates a vulnerability to fraud.

DoD does not plan to request any additional funding for projects to restart SOEs because the Government of Iraq has significantly increased its capital budget to rehabilitate SOEs and has begun to enter into joint ventures with foreign investors to manage some SOEs. Any remaining assistance is likely to be technical in nature, rather than involving purchases of equipment.



SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

January 30, 2009

MEMORANDUM FOR U.S. SECRETARY OF DEFENSE
DEPUTY UNDER SECRETARY OF DEFENSE FOR BUSINESS
TRANSFORMATION
U.S. AMBASSADOR TO IRAQ

SUBJECT: Full Impact of Department of Defense Program to Restart State-owned Enterprises
Difficult to Estimate (SIGIR 09-09)

We are providing this audit report for your information and use. It discusses efforts to reopen state-owned enterprises in Iraq, led by the Department of Defense's (DoD) Task Force to Improve Business and Stability Operations in Iraq. The audit was conducted by the Special Inspector General for Iraq Reconstruction (SIGIR) as project 8035, under the authority of Public Law 108-106, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978.

We considered comments from the Deputy Under Secretary of Defense for Business Transformation when preparing the final report. The comments are addressed in the report, where applicable, and a copy is included in the Management Comments section of this report.

We appreciate the courtesies extended to the SIGIR staff. For additional information on this report, please contact Glenn Furbish at ([703-428-1058](tel:703-428-1058)/glenn.furbish@sigir.mil).

Stuart W. Bowen, Jr.
Inspector General

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Full Impact of Department of Defense's Program To Restart State-owned Enterprises Is Difficult To Estimate

SIGIR-09-009

January 30, 2009

Executive Summary

Introduction

Since the inception of the war in 2003, Iraq has reportedly had an approximate 60 % underemployment/unemployment rate. The Department of Defense (DoD) believed that this high rate was a factor in fueling insurgency in the country in 2006. In June 2006, DoD established a Task Force to Improve Stability and Business Operations in Iraq (Task Force) to stimulate economic development and employment in Iraq. One of the Task Force's major efforts has been to revitalize Iraqi state-owned enterprises (SOE), which are factories that played an important role in Iraq's pre-war economy. SOEs employed about 200,000 Iraqis, according to DoD officials. The Task Force received about \$50 million in Fiscal Year (FY) 2007 and \$53 million in FY 2008 to revitalize SOEs. Projects associated with the FY 2007 funding are being implemented, although most of projects associated with the FY 2008 funding have not yet been given final approval for implementation. Once a project is selected for funding, the Task Force enters into a cooperative agreement with the SOE to implement the project. These agreements describe the assistance to be provided, the project time frames, and the procedures for the disbursement of funds. SIGIR's reporting objectives for this report were to assess the following:

- the baseline data and performance metrics the Task Force used to estimate the impact of its projects
- the adequacy of management controls the Task Force has in place to mitigate risk and ensure funds are used for the intended purposes
- the Task Force's future plans to assist state-owned enterprises

In July 2008, SIGIR reported on the financial resources devoted to the Task Force, and the major areas of economic development assistance, along with examples of projects.¹

¹ *Information on a Special Department of Defense Program to Foster Economic Recovery in Iraq*, SIGIR-08-024, July 29, 2008.

Results

The Task Force faced a very difficult security environment, particularly as it launched the initial phases of its efforts. Nonetheless, its efforts have served to help restart SOEs and provide employment. However, the full measure of the Task Force's impact is difficult to estimate because of the absence of good baseline data and weaknesses in the methodology used to identify the number of jobs impacted by the effort. Task Force officials cited two primary reasons why reliable baseline data could not be established on actual production levels and numbers of employees working at each SOE prior to providing assistance. First, security considerations limited the time available to tour individual factories and identify potential projects that could improve operations. Second, Task Force assessment teams had to rely on testimonial evidence on the status of production and number of employees working. Absent reliable data, the Task Force developed an alternate methodology to estimate job impact.

Because the goal of the FY 2007 projects was to return people to work, the Task Force decided to use employment impact as the sole performance metric to assess the impact of the projects. Job impact was defined as returning people to work that were already on an SOE's payroll but were not working because the factory was inoperable or did not have sufficient work for all employees. The Task Force estimated the FY 2007 projects impacted about 24,500 jobs. However, SIGIR was unable to validate the methodology used because there was no supporting documentation on how it was developed. Also, SIGIR found a number of anomalies in individual impact projections. For example, some estimates were based on the total number of employees in a state-owned enterprise rather than the number of employees at the individual factory being assisted. SIGIR does not believe that this approach provides a reliable basis for predicting job impact. Going forward, the Task Force has developed performance metrics involving impact on employment, production, and sales and plans to establish a baseline for these metrics to better assess the impact of FY 2008 projects.

Additionally, the Task Force has not been able to impact employment as quickly as initially expected because projects are taking longer to implement than planned. The Task Force originally expected to implement most of the FY 2007 projects within six months. However, only one project was completed within six months and most of the projects are now estimated to take more than 13 months to implement. Task Force officials stated that projects are taking longer to implement because of delays in obtaining detailed requirements from the SOEs and the time required to process procurement actions.

SIGIR's work identified three areas where internal controls can be improved. Two related to funding provided directly to SOEs through electronic transfer or cash payments to make purchases, and the third area involves contracts awarded directly by the U.S. for items to be delivered directly to SOEs. In the first instance SIGIR found that although the Task Force verifies that items purchased directly by SOEs are received, it does not obtain copies of invoices to verify the cost of these items. Because about \$18 million (61%) of the funds disbursed as of November 30, 2008 have been transferred directly to SOEs to purchase raw material or equipment, it is important for the Task Force to verify the cost of these items to ensure full accountability of funds. In the second instance, SIGIR found two cases in which the Task Force provided the equivalent of \$229,400 in Iraqi dinars to two SOEs, but has not verified how these funds were used. In the third instance, SIGIR found that items purchased on U.S. contracts were

often paid for before verifying receipt of the items by the SOEs. SIGIR found that receipt verification has occurred after the fact, but this practice creates a vulnerability to fraud. In commenting on a draft of this report, the Director noted that only one payment was made for general operating expenses and that the other payments were made to procure raw materials and, in the case of the Tikrit Flour factory, for expenses to open the factory. We were unable to verify this new information but included it to fully present the Task Force's position. We will verify this data when we follow up on our recommendations.

The Director of the Task force told SIGIR that there are no plans to request any additional funding for projects to restart SOEs because the GOI has significantly increased its capital budget to rehabilitate SOEs and has begun to enter into joint ventures with foreign investors to manage some SOEs. He noted, however, that the Task Force has contracts with two consulting firms to provide technical assistance and build the capacity of the Iraq Ministry of Industry and Minerals and the management of the SOEs. These contracts will extend until the end of FY 2009. The contracts include helping the Ministry negotiate joint ventures with foreign investors and helping SOEs develop business plans. Further assistance beyond 2009 would be contingent upon GOI funding.

Recommendations

To ensure that reliable data is available to assess the impact of projects being implemented with FY 2008 funds, SIGIR recommends that the Deputy Under Secretary of Defense for Business Transformation require the Task Force to establish milestones for the timely collection of baseline data associated with the recently created performance metrics.

To improve accountability over U.S. funds and reduce vulnerability to fraud, SIGIR recommends that the Deputy Under Secretary of Defense for Business Transformation direct the Task Force to (1) obtain copies of invoices to verify the cost of items purchased directly by SOEs; and (2) follow existing internal control procedures and verify receipt of items at SOEs before payment is made under contracts awarded by the Joint Contracting Command-Iraq/Afghanistan.

Management Comments and Audit Response

The Deputy Under Secretary of Defense for Business Transformation, Director, Task Force to Improve Business and Stability Operations, Iraq provided comments on a draft of this report. A copy of the comments is in Appendix E. The Director stated that he appreciated the recommendations made in the report and is working to implement them. However, he also noted that he believes the report falls short in acknowledging the environment that existed at the time the program was started, and their conservative approach to establishing an estimate of jobs impacted, the strong validation and verification procedures in place, and the impacts to the stabilization of Iraq the program has made. He further noted that the Task Force's ability to spend time and money doing detailed "baselining" during the worst period of insurgent activity was very limited. However, they are acquiring the services of a professional accounting firm to audit the entire "value chain" impact of their efforts.

Our final report notes that the Task Force faced a very difficult security environment, particularly as it launched the initial phases of its efforts. Nonetheless, the task force's efforts have served to help restart state-owned factories and provide employment. However, we continue to believe that the program's full success is difficult to measure without adequate baseline data. We are encouraged that the Task Force plans to engage an accounting firm to determine the impact of their efforts. The Task Force Director also noted that Task Force's efforts have led to foreign and private investment in the SOEs it has reopened, and that it is working with the GOI to increase the budget of the Ministry of Industry and Minerals. Our draft report discussed both of these issues and this report was updated to reflect information provided by DoD.

The Director recognized SIGIR's concern regarding controls over disbursements but went on to note various risk mitigation measures they had in place including that Task Force personnel physically verify receipt of equipment and material. Our draft report recognized that the Task Force verifies physical receipt of equipment and material, but we continue to believe that obtaining an invoice is a standard part of an effective management control process.

The Director provided additional information on disbursements which we incorporated into this report as appropriate. Finally, DoD noted that a system is in place to ensure that the Task Force and JCC-I/A coordinate before an invoice is paid. Our draft report stated that a system is in place; however, our work shows this process was not always followed.

Introduction

This report, the second SIGIR report on efforts of the Department of Defense (DoD) Task Force to Improve Business and Stability Operations in Iraq (Task Force), examines DoD's efforts to restart and revitalize Iraqi state-owned enterprises (SOEs).² For several years SIGIR has focused heavily on audits of Iraq reconstruction projects under its oversight authority, which has been tied to the sizeable Iraq Relief and Reconstruction Fund. Over time, the Congress has provided SIGIR increased oversight authority over other funds that provide support to Iraq relief and reconstruction activities, such as the Economic Support Fund, and similar funding provided by DoD to support economic recovery in Iraq. SIGIR has initiated audits in these areas to assess management of the efforts and outcomes.

Background

In a memorandum dated June 22, 2006, the Deputy Secretary of Defense tasked the Deputy Under Secretary of Defense for Business Transformation to lead an effort in accelerating reconstruction operations in Iraq. In the memorandum, the Deputy Secretary established the Task Force to Improve Business and Stability Operations in Iraq and stated that "Economic development and job creation in Iraq are critical success factors to build a stable country." The memorandum stipulated that in leading Task Force, the Deputy Under Secretary was to draw on the resources of the Business Transformation Agency.³ The Task Force has offices in Arlington, Virginia and in Baghdad, Iraq. The Task Force has 6 U.S. government personnel and 28 contractor personnel involved in the effort to restart state-owned enterprises. U.S. government personnel approve projects for funding and provide overall management oversight while the contractors monitor project execution, business plan development, and verify that items purchased are delivered to the SOEs.

Before the war, about 200 SOEs were in Iraq. These enterprises included cement, chemical, construction, dairy, industrial, and textile operations. According to DOD, these enterprises employed about 200,000 people. This workforce was largely idled as a result of the war and its aftermath. The Congress authorized about \$100 million and DoD allocated an additional \$3 million of its FY 2008 funds for Task Force efforts to revitalize SOEs. As shown in Table 1, about \$67.6 million have been obligated and about \$27 million had been disbursed as of November 30, 2008.

² *Information on a Special Department of Defense Program to Foster Economic Recovery in Iraq*, SIGIR-08-024, July 29, 2008.

³ The Deputy Under Secretary oversees the Business Transformation Agency, which is accountable for delivery of common processes and systems supporting logistics, acquisition, finance, and personnel activity in DoD.

Table 1 – Funding to Revitalize State-owned Enterprises (dollars in millions)

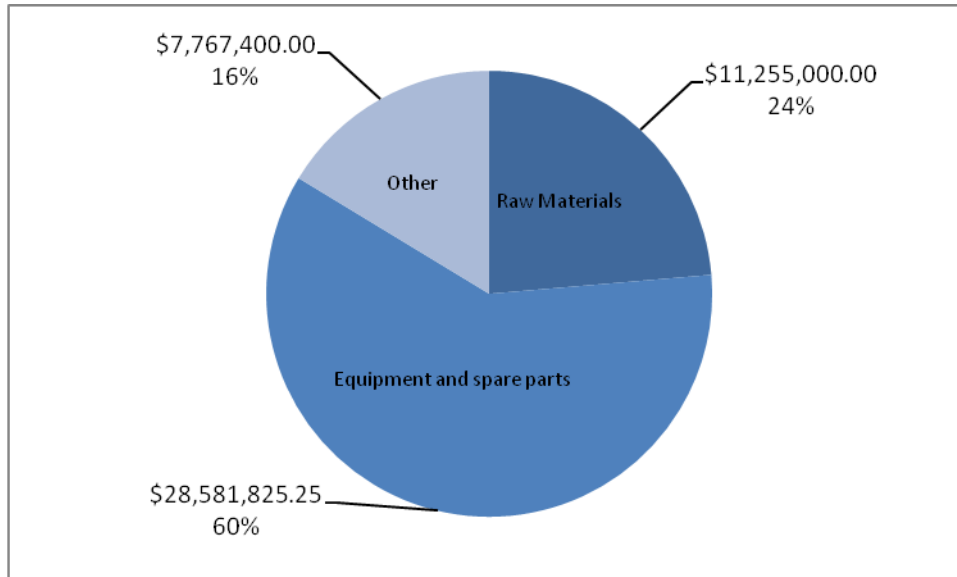
Funding Source	Authorized	Obligations	Disbursements
FY07 Iraqi Freedom Fund	\$50.0	\$49.0	\$27.0
FY08 Emergency and Extraordinary Expense Fund	\$ 3.0	\$3.0	\$0
FY08 Iraqi Freedom Fund	\$50.0	\$15.6	\$0
Totals	\$103.0	\$67.6	\$27.0

Source: DoD.

As of November 30, 2008, about \$35.4 million of the authorized funds have not been obligated.

The Task Force evaluated over 70 projects and funded projects in 34 SOEs in FY 2007. These projects were primarily located in Baghdad and in central Iraq and were selected to help reduce unemployment and insurgency in densely populated areas. The majority of the FY 2007 funding has been used to purchase equipment, spare parts, and raw materials as shown in figure 1.

Figure 1 – Use of FY 2007 Funding



Source: SIGIR analysis of DoD data.

Appendix B shows the items purchased with FY 2007 funds by SOEs.

For FY 2008, the task force received requests for about \$224 million in assistance from SOEs. The Task Force used eight criteria to evaluate project requests. These criteria included the Multi-National Force Commander’s priorities, impact on employment, sustainability, and market for products. As of November 30, 2008, the Task Force had approved 12 projects for \$15.8

million and another 18 projects for about \$30.1 million were still under review. The remaining \$4 million is being held in reserve for new projects, or changes to ongoing projects.

Once a project is selected for funding, the Task Force enters into a cooperative agreement with the SOE. The agreement describes the assistance to be provided, the project time frames, and the procedures for the disbursement of funds. Funds can be disbursed through contracts awarded by the Joint Contracting Command-Iraq/Afghanistan (JCC-I/A)⁴, or through an electronic fund transfer or cash payment directly to a state-owned enterprise to make its own purchases. The Task Force prefers that JCC-I/A award contracts to maintain better control over the funds.

Objectives

SIGIR's objectives for this report were to assess the following:

- the baseline data and performance metrics the Task Force used to estimate the impact of its projects
- the adequacy of management controls the Task Force has in place to mitigate risk and ensure funds are used for the intended purposes
- the Task Force's future plans to assist state-owned enterprises

For a discussion of the audit scope and methodology, see Appendix A. For a list of SOEs assisted with FY 2007 funds, see Appendix B. For a list of acronyms used in this report, see Appendix C. For a list of audit team members, see Appendix D. For comments received from the DoD, see Appendix E.

⁴ The JCC-I/A was created in November, 2004 to manage DoD contracting in Iraq and Afghanistan.

Lack of Reliable Baseline Data and Performance Measures Make It Difficult to Fully Estimate Impact

The Task Force efforts have helped to restart state-owned factories through the purchasing of equipment, spare parts, and raw materials. However, the full measure of its impact is difficult to estimate because baseline data on the number of employees actually working and actual production could not be established at the SOEs that were assisted. Furthermore, SIGIR was unable to validate the methodology used because there was no supporting documentation on how it was developed. SIGIR does not believe it provides a reliable basis for estimating job impact. Additionally, achieving employment impact has taken longer than expected due to the longer than anticipated time required to implement the projects.

Limited Baseline Data from Which to Track Progress

Our review of factory assessments completed by the Task Force showed that they did include estimates of the number of employees currently working and the number that could be achieved if the factory was operating at design capacity. In addition, most assessments included information on the factory's designed production capacity but not current actual production. Some assessments did include estimates of current production which were obtained from the Iraqi management team or estimated by the Task Force site assessment team. For example, the assessment for the State Company for Cotton indicated that the operating capacity of the factory was unclear but estimated that it was between 30 and 50% depending on employee attendance and power.

Task Force officials acknowledge limitations in baseline data and cited two primary reasons why reliable baseline data could not be established. First, for security reasons the teams that conducted factory assessments had only one hour to tour each of the factories and identify potential projects that could improve operations. Secondly, the assessment teams had to rely on testimonial evidence from the Iraqi management team on the status of production and number of employees working.

The Task Force officials has recently developed performance metrics such as impact on employment, production, and sales and plans to establish a baseline for these metrics to better assess the impact of FY 2008 projects. In addition, the Task Force plans to have a public accounting firm validate the actual jobs created at the SOEs.

Methodology for Estimating Job Impact Has Weaknesses Limiting Its Reliability

The Task Force obtained data on employment from six SOEs which it reportedly used in developing a methodology to estimate the impact at the 26 other SOEs assisted in FY 2007. The

Task Force visited 12 SOEs and requested they provide data on employment impact. According to Task Force officials, six SOEs provided data indicating that 7,560 jobs would be impacted. This data indicated that 19 to 60% of the jobs at these SOEs were impacted. For example, the State Company for Mechanical Engineering estimated that 1,100 of 5,902 (19%) of the jobs would be impacted while the Najaf Ready to Wear Company estimated that 1,800 of 3,019 (60%) of the jobs would be impacted.

The methodology developed by the Task Force used various percentage factors to multiply against the total number of employees in an SOE, to project an employment impact (see table 3). For example, the Task Force estimated 1,199 jobs at State Company for Electrical Industries would be impacted by multiplying a 25% impact factor times 4,797 (the total number of employees in the company).

Table 3 – Percentage Impact Factors Used to Estimate Employment Impact for FY 2007 Projects

Number of Employees	Percentage Impact Factor
1,000 or less	35%
1,001 to 3,000	30%
3,001 to 5,000	25%
Greater than 5,001	20%

Source: DoD.

As noted in the table, various employer impact percentages (multipliers) were used depending on the number of employees. According to Task Force officials, the various employment impact percentages were developed after evaluating the employment impact data provided by the six SOEs. However, no documentation supports how the percentage impact factors were developed, and a number of anomalies were identified in individual impact projections.

In some cases, the Task Force estimates of employment impact seem overstated because they based their estimate on the total number of employees in a company rather than the number of employees at the factories being assisted. For example:

- The Task Force estimated that 1,522 (20%) of the 7,622 jobs at the State Company for Dairy Products would be impacted when a milk plant under construction is completed in March 2009. However, during our November 2008 visit to the construction site, the engineer estimated that about 600 people would be employed once the milk plant is completed. The Task Force based its estimate on the total number of employees in the entire company. This company had the fifth highest estimated employment impact.

- The Task Force estimated that 1,231 (25%) of the 4,822 jobs at the State Company for Leather would be impacted. However, during our November 2008 visit to the factory, the Director General stated that the factory had 1,386 employees. Thus, using the Task Force methodology only 416 jobs would be impacted (1,386 X 30%). This company had the sixth highest estimated employment impact.
- The Task Force estimated that 1,199 (25%) of the 4,797 jobs at the State Electrical Company would be impacted. The company has several plants but the Task Force project involves only the air-conditioning plant. The company's September 2008 business plan indicates that 1,545 employees are at this plant. Thus, using the Task Force methodology only 464 jobs would be impacted (1,545 x 30%). This company had the eighth highest estimated employment impacts.

Our work identified other areas that raise questions about the actual employment impact, as shown in the following examples.

- The Task Force estimated that its project would impact 1,885 of the 9,424 jobs at the State Company for Textiles-Hilla. However, the November 9, 2006 factory assessment relied on by the Task Force indicates that 3,000 employees were working and they already were at maximum plant capacity, and the Task Force funding was simply used to purchase raw materials. This company had the highest estimated employment impact.
- The Najaf Ready to Wear Company reported to the Task Force that 1,800 jobs were impacted. The November 6, 2006 factory assessment relied on by the Task Force indicated that 1,700 people were currently working and 800 more could be employed if more orders were received. The company's September 2008 business plan indicates the company has 1,710 employees. This company had the second highest estimated employment impact.

A Task Force official stated that the Ministry of Industry and Minerals (MoIM) provided the number of employees at each SOE. This official indicated the data may represent total employees for each SOE versus employees by factory, but stated that it was the best data available at the time. Finally, the Task Force official stated that some of the projects are assisting more than one factory per SOE. We also recognize that increased employment at a given factory could have a secondary impact through creation of jobs in supporting industries such as truckers and distributors. The Task Force's methodology, as described to us, did not specifically account for this secondary impact, and the data issues we identified make it difficult to rely on the data to estimate real employment impact.

The Task Force estimates that the FY 2008 projects already approved and under consideration will impact about 3,200 jobs, which is significantly less than the FY 2007 projects for the same investment. Task Force officials stated that the majority of the estimated impact is based on SOE project proposals from business plans that they had developed, but which did not exist in 2007. Task Force officials noted that once all FY 2008 projects are approved, they plan to interview management staff at each factory being assisted to verify the number of employees that

will be impacted. Task Force officials believe the number of jobs impacted will increase based on data collected during their site visits.

Quick Impact on Employment Difficult to Achieve

The Task Force has not impacted employment as quickly as anticipated because projects are taking longer to implement than planned. The Task Force originally planned to implement most of the FY 2007 projects within six months from the date the cooperative agreements were signed. However, only one project was completed within six months and most projects are now estimated to take more than 13 months to implement. According to Task Force officials, the 180-day estimate proved to be unrealistic and that they set this as a goal since MNF-I was encouraging them to complete the projects quickly to help improve the security environment.

Our analysis indicates that 20 of the 34 (59%) of the FY 2007 projects at SOEs being assisted are now estimated to take more than one year to implement, as shown in table 4.

Table 4 – Estimated Time to Complete FY 2007 Projects and Estimated Employment Impact

Estimated Months to Complete	Number of Projects	Percent	Estimated Employment Impact
6 or less	1	3%	84
7 to 12	13	38%	8,915
13 to 18	19	56%	14,403
More than 18	1	3%	1,027
Total	34	100%	24,429

Source: SIGIR analysis of DoD data.

Projects are taking longer to complete for several reasons. First, it is taking longer than anticipated to implement projects because of the time required for the SOEs to develop their requirements. For contracts awarded by JCC-I/A, our analysis indicates that it takes an average of 180 days (from a range of 30 to 330 days) for JCC-I/A to award a contract once a cooperative agreement has been signed. Task Force officials stated that obtaining a detailed list of requirements from some SOEs has taken longer than anticipated. For example, the Task Force signed a cooperative agreement with the Fallujah Cement Company in September 2007 to purchase generators and equipment, but the company did not provide the Task Force with detailed equipment requirements until June 2008. Secondly, Task Force officials stated that some projects are delayed because of the time required for JCC-I/A to award a contact once it receives the requirements from the Task Force.

Thirdly, some projects have been delayed because some SOEs changed how they were going to use the funds after the cooperative agreement was signed. For example, in 2008 the State

Company for Northern Fertilizer signed a cooperative agreement for \$5 million to purchase generators. However, in February 2008 the company notified the Task Force that it had purchased the generators from another source and now wanted to use the funds to buy various other pieces of equipment. JCC-I/A awarded contracts for \$1.7 million in August and September 2008 for the other items; however, the equipment is not scheduled to be delivered until March through July 2009. Furthermore, requirements for the remaining \$3.3 million in available funds have yet to be determined.

Based on their experience with FY 2007 projects, the Task Force has increased the planned implementation period for FY 2008 projects to one year. Task Force officials recognize that one year is still shorter than the projected implementation period for the majority of the FY 2007 projects. Task Force officials stated they have taken steps to improve communications with the SOEs. First, the kick-off meetings are limited to four SOEs at a time to allow for more one-on-one attention. One official stated that this provides the opportunity to inform the SOEs that the faster they identify their specific requirements the faster their operations will be impacted. In FY 2007, the Task Force had one kick-off meeting with all 34 SOEs. In addition, the Task Force has moved staff to Basrah to manage the projects in southern Iraq to increase interaction between the Task Force and SOEs that are being assisted, and are considering moving some staff to manage projects in northern Iraq.

Controls over Disbursements Can be Improved

SIGIR’s work identified three areas where internal controls can be improved, two related to funding provided directly to SOEs to make purchases, and a third area involving contracts awarded directly by the U.S. for items to be delivered directly to SOEs. In the first instance SIGIR found that while the Task Force verifies that items purchased directly by SOEs are received, it does not obtain copies of invoices to verify the cost of these items. In the second instance, we found two cases where the Task Force provided the cash equivalent of \$229,400 in Iraqi dinars to two SOEs, but has not verified how these funds were used. In the third instance, SIGIR found that items purchased on U.S. contracts were often paid for before verifying receipt of the items by the SOEs. SIGIR found that verification of receipt has occurred after the fact, but this practice creates a vulnerability to fraud.

The Task Force disburses funds through contracts awarded by JCC-I/A or direct transfers to SOEs. As of November 2008, about \$16.7 million (61%) of disbursements have been direct transfers to SOEs, as shown in table 5.

Table 5 – Disbursement of Funds (as of November 2008)

Method	Amount Disbursed	Percentage
Contracts awarded by JCC-I/A	\$10,567,353	39%
Direct disbursements to SOEs ¹	\$16,702,140	61%
Total	\$27,269,493	100%

Source: SIGIR analysis of DoD data.

Note: ¹ Electronic and cash payments.

The Task Force prefers to award contracts through JCC-I/A to maintain better control over the funds. When JCC-I/A awards a contract, funds are not supposed to be disbursed until the Task Force verifies that items have been delivered to an SOE. However, under direct fund transfer, funds are considered disbursed when the transfer occurs, which is before delivery of material. Task Force officials recognize that direct transfers create a greater vulnerability to fraud and waste because it has less visibility regarding actual purchases. Nevertheless, we noted weaknesses in each of these areas.

Control over Use of Funds Provided Directly to SOEs Can Be Improved

Funds provided directly to SOEs are either in the form of an electronic fund transfer or cash payment. The Task Force verifies that items purchased directly by SOEs are received, but does not obtain copies of invoices to verify the cost of these items. Additionally, we identified a

couple of instances where cash was disbursed directly to SOEs to be used for general operating expenses without follow-up to see how these funds were used. The absence of a verification requirement creates a vulnerability to undetected fraud since about \$16.7 million (60%) of disbursements as of November 30, 2008 were made through fund transfers made directly to SOEs.

The following example illustrates the importance of obtaining copies of invoices to support SOE's direct purchases. During March and May 2008, the Task Force transferred \$635,000 electronically to the Ninewa Furniture factory to purchase raw materials, equipment, and spare parts. In August 2008, the Task Force verified that the State Company for Furniture-Ninewa had purchased and received spare parts valued at \$55,565, and that two pieces of equipment costing \$245,000 were ordered but had not been delivered. While the Task Force performs visual inspections to verify that the spare parts were delivered, it did not obtain copies of invoices or contracts that showed the dollar value of the spare parts received or the equipment on order.

In November 2008, the Task Force returned to the company to verify that the equipment on order during their previous visit had been received. During this visit, the Task Force learned that the Director General had been fired for his failure to follow the company's procedures for purchasing equipment. Available documentation indicates that the Director General had purchased a generator and forklift without prior approval and solicited only one bid for the various purchases, while company policy requires three bids to be obtained. The Director General was able to purchase the generator and fork lift for \$27,000 because the contract for the spare parts was for \$23,839 and not \$55,565 as previously reported. Finally, the Task Force learned that the company had terminated the contract for the two pieces of equipment that had not been delivered. However, a certain portion of these funds were wasted because the company lost the \$23,700 down payment it had made on the original contract.

Furthermore, in two cases, involving cash given directly to SOEs, the Task Force provided the equivalent of \$229,400 in Iraqi dinars to two SOEs. Between September and November 2007, the Task Force provided the Director General of Tikrit Flour the equivalent of \$150,000 in Iraqi dinars and in June provided \$27,400 in Iraqi dinars. Likewise, in June 2008, the Task Force gave the Director General of KRG Carpet the equivalent of \$52,000 in Iraqi dinars. According to Task Force officials these cash payments were for general operating expenses and represent the only cases where cash was disbursed. However, we found that the Task Force had not verified how these funds were actually used by the SOEs.

In commenting on a draft of this report, the Director noted that only one payment was made for general operating expenses and that the other payments were made to procure raw materials and, in the case of the Tikrit Flour factory, for expenses to open the factory. We were unable to verify this new information but included it to fully present the Task Force's position. We will verify this data when we follow up on our recommendations.

Payments Made On U.S. Contracts before Verification of Receipt

The internal control procedures for contracts awarded by JCC-I/A call for the Task Force to verify receipt of items before payment is made by JCC-I/A. However, we found this procedure

is not being followed. Our analysis indicates that about \$7.6 million of the \$10.6 million (72%) of disbursements under JCC-I/A awarded contracts through November 30, 2008 was disbursed prior to the Task Force verifying receipt of the items. For example, JCC-I/A disbursed \$211,863 in March 2008 for various pieces of equipment purchased for the State Company for Drugs, but the Task Force did not verify receipt of the items until September 2008. This occurred because JCC-I/A processes invoices for payment as they are received and does not have procedures to check with the Task Force if the items have been received. The Director, in responding to our draft report commented that procedures are in place to ensure verification of receipt of goods before funds are disbursed. Nonetheless, our analysis indicated that verification had not taken place.

Future Assistance to SOEs Expected to Be Limited

According to the Deputy Under Secretary of Defense for Business Transformation, DoD does not plan to request any more funding for projects to restart SOEs. He stated that no further funding is needed because the Government of Iraq has significantly increased MoIM's capital budget to rehabilitate SOEs and has begun to enter into joint ventures with foreign investors to operate some SOEs.

The Advisor to the Minister of Industry and Minerals noted that when DoD efforts to restart SOEs began in 2006, MoIM's capital budget for SOE's improvement projects was about \$10 million, and it was about \$30 million in 2007. He noted that the DoD funding allowed MoIM to begin revitalizing some SOEs. However, the Director, in commenting on our draft report, noted that the capital budget increased to \$500 million in 2008. Furthermore, the Special Advisor noted that Government of Iraq's strategy is to invest in SOEs to make them attractive for joint ventures with foreign investors. The Advisor noted that MoIM is responsible for 67 SOEs and believes that between 15 to 25% are currently attractive to investors; 35 to 55% need some additional GoI funding to make them attractive; and the remainder are not viable for foreign investment. He stated that the GoI has recently entered into joint ventures with foreign investors for two state-owned cement companies and is in the process of negotiating additional agreements. In addition, the Deputy Under Secretary of Defense for Business Transformation noted that the GoI has recently signed memorandums of understanding with foreign investors to invest \$280 million in a state-owned fertilizer company and \$80 million in a state-owned electrical company, and in commenting on our draft report noted that over \$900 million in foreign private investment was secured in formerly idled state owned factories in Iraq. The Deputy Under Secretary of Defense believes these joint ventures also demonstrate the impact of the Task Force's efforts in Iraq.

The Task Force has contracts with two consulting firms to provide technical assistance and build the capacity of MoIM and the SOE management which will extend until the end of FY 2009. These contracts include helping MoIM negotiate joint ventures with foreign investors and helping SOEs develop business plans. According to the Deputy Under Secretary of Defense for Business Transformation, if MoIM wants this technical assistance to continue beyond FY 2009, they will have to pay for it.

Conclusions and Recommendations

Conclusions

The Task Force faced a very difficult security environment, particularly as it launched the initial phases of its efforts. Nonetheless, the Task Force's efforts have served to help restart state-owned factories and provide employment. However, without baseline data it is difficult to accurately estimate the full impact of Task Force efforts to restart state-owned enterprises. In addition, there is some question about the extent of employment impact related to the projects funded in FY 2007. We are encouraged that the Task Force has established performance metrics for projects being implemented with FY 2008 funds, and plans to develop baseline data.

Although controls were in place to ensure the receipt of items before payments were made, they were not always followed. Further, effective controls were not in place for electronic and cash payments, thus creating a vulnerability to fraud and waste.

Recommendations

To ensure that reliable data is available to assess the impact of projects being implemented with FY 2008 funds, SIGIR recommends that the Deputy Under Secretary of Defense for Business Transformation require the Task Force to establish milestones for the timely collection of baseline data associated with the recently created performance metrics.

To improve accountability of U.S. funds and reduce vulnerability to fraud, SIGIR recommends that the Deputy Under Secretary of Defense for Business Transformation require the Task Force to (1) obtain copies of invoices to verify the cost of items purchased directly by SOEs; and (2) adhere to existing internal control procedures and verify receipt of items at SOEs before payment is made under contracts awarded by JCC-I/A.

Management Comments and Audit Response

The Deputy Under Secretary of Defense for Business Transformation, Director, Task Force to Improve Business and Stability Operations, Iraq (TFBSO) provided comments on a draft of this report. A copy of this letter is in Appendix E. The Director stated that he appreciated the recommendations made in the report and is working to implement them. However, he also noted that he believes the report falls short in acknowledging the environment that existed at the time the program was started, and their conservative approach to establishing an estimate of jobs impacted for use in internal MNF-I reporting, the strong validation and verification procedures in place, and the impacts to the stabilization of Iraq the program has made. He further noted that TFSBO's ability to spend time and money doing detailed "baselining" during the worst period of insurgent activity was very limited. However, they are acquiring the services of a professional accounting firm to audit the entire "value chain" impact of their efforts.

Our final report notes that the Task Force faced a very difficult security environment, particularly as it launched the initial phases of its efforts. Nonetheless, the task force's efforts have served to help restart state-owned factories and provide employment. However, we continue to believe that the program's full success is difficult to measure without adequate baseline data. We are encouraged that the Task Force plans to engage an accounting firm to determine the impact of their efforts. The Task Force Director also noted that Task Force efforts have led to foreign and private investment in SOEs it has reopened, and that it is working with the GoI to increase the budget of the Ministry of Industry and Minerals. Our draft report discussed both of these issues and this report was updated to reflect information provided by DoD.

The Director recognized SIGIR's concern regarding controls over disbursements of equipment and funds but went on to note various risk mitigation measures that were in place including that Task Force personnel physically verify receipt of equipment and material. Our draft report recognized that the Task Force verifies physical receipt of equipment and material, but we continue to believe that obtaining an invoice is a standard part of an effective management control process.

The Director provided additional information on disbursements which we incorporated into this report as appropriate. Finally, DoD noted that a system is in place to ensure that the Task Force and JCC-I/A coordinate before an invoice is paid. Our draft report stated that a system is in place; however, our work shows this process was not always followed.

Appendix A—Scope and Methodology

Under the authority of Public Law 108-106, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended, SIGIR performed an audit of the performance metrics and internal controls used by the Task Force to Improve Business and Stability Operations in Iraq to ensure that U.S. funds have been used for their intended purposes. We performed our work in Arlington, Virginia and Baghdad, Iraq. We conducted this performance audit from October 2008 through January 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform an audit to obtain sufficient information, and appropriate evidence to provide a reasonable basis for our results based on our audit objectives. Based on those objectives, we believe that the evidence obtained provides a reasonable basis for our results.

We conducted work at the Task Force locations in Washington, D.C. and Baghdad, Iraq. We also visited the following five state-owned enterprises: the State Company for Dairy Products, the State Company for Heavy Equipment Engineering, the State Company for Leather Industries, the State Company for Rubber Industries and the State Company for Woolen Industries. We selected these companies because they were in the top ten for funding or for estimated employment impact. Security requirements limited the number of state-owned enterprises we could visit, and the time available at each site.

To assess the baseline data and performance metrics used to evaluate the program's impact, we reviewed data in the Task Force project management system, known as Mercury, and interviewed Task Force officials to identify the baseline data on the estimated employment impact from the Task Force. For FY 2007 projects, we interviewed Task Force officials regarding the methodology they used to estimate employment impact. For FY 2008 projects, we reviewed SOE projects proposals that estimated employment impact. We also obtained information on employment impact from Iraqi officials at the five factories we visited. To analyze the time to implement the FY 2007 projects, we compared the completion dates in the cooperative agreements to the actual or estimated completion dates in the Mercury project management system. To determine why projects were taking longer to implement than planned, we analyzed the time between the signing of cooperative agreements and contract awards as well as time between contract award and the receipt of equipment at the SOE. We also interviewed Task Force officials to obtain their views on why projects were taking longer to implement than planned and the actions they have taken to improve implementation of FY 2008 projects.

To assess the management controls established to guide project execution and mitigate risk, we interviewed Task Force, JCC-I/A, and contractor officials, who developed internal control procedures and reviewed those procedures. In addition, we interviewed a senior official from the firm hired by the Task Force to verify receipt of goods at the SOEs. We tested the internal controls over disbursements through JCC-I/A and those made directly to SOEs through direct fund transfers. For direct fund transfers, we reviewed documentation supporting the transfer and receipt of funds to an SOE's bank account. In addition, we reviewed all site visit reports that verified the receipt of raw material or equipment purchased directly by an SOE.

To determine the Task Force's future plans to assist state-owned enterprises, we interviewed the Deputy Under Secretary of Defense for Business Transformation regarding DoD plans to assist SOEs beyond FY 2008. We also interviewed the Advisor to the Minister of Industry and Minerals regarding GOI plans and funding for SOEs.

Use of Computer-Processed Data

For the purposes of this review, we obtained information from the Task Force's project management database referred to as Mercury and the JCC-I/A's Joint Contingency Contracting System. The Task Force provided SIGIR with direct access to the Mercury database. For individual projects, we reviewed information such as overall timeframes, cooperative agreements and modifications to these agreements, site visit reports, and other information related to contact with the SOEs being assisted for each FY 2007 project. Task Force officials stated that they began using this system in August 2008 and that it may not contain all the documentation for FY 2007 projects because they were generally started between August and September 2007. We relied on the database primarily for actual or estimated completion dates and for copies of the site visit reports.

We also obtained data on disbursements from JCC-I/A's Joint Contingency Contracting System. We verified the data with a spreadsheet maintained by JCC-I/A for the Task Force that showed the status of obligations and disbursement by project.

Prior Coverage

SIGIR previously reported on the financial resources devoted to the Task Force, and the major areas of economic development assistance, along with examples of completed and planned projects.⁵

⁵ *Information on a Special Department of Defense Program to Foster Economic Recovery in Iraq*, SIGIR-08-024, July 29, 2008.

Appendix B—State-owned Enterprises Assisted with FY2007 Funds

State-owned enterprise	FY 2007 Funding	Description of items purchased
Abu Ghraib Dairy	\$3,425,000	Construction of a milk processing plant
Al Faris State Company	\$220,000	Welding and bending machines
Al Furat Company	\$1,500,000	Generators, fuel tank, welding machines, and spare parts for heat exchanger
Anna Ready to Wear	\$275,000	Fabric
Baiji Fertilizer	\$6,600,000	Caustic soda flakes, cement, motors, and spare parts
Basrah Chemical	\$250,000	Seals, gaskets, and valves for boilers
Diyala Electric	\$1,550,000	Equipment to improve transformer and power distribution production lines
Fallujah Cement	\$1,500,000	Generator and spare parts
General Systems Company	\$150,000	Engineering services
KRG carpet	\$52,000	General operating expenses
Mosul Ready to Wear	\$1,825,000	Fabric, embroidery and dyeing machines, and spare parts
NASSR	\$460,000	Forklift, welding machines, plasma cutter, and control panels for heating system
National Bike	\$128,850	Brake presses for wheelchairs
Najaf Ready to Wear	\$1,500,000	Spreading machines, scanner, bias group equipment, sewing machines, and final pressing equipment
Ninewa Furniture	\$635,000	Wood to build furniture for trailers
State Company for Agricultural Supplies	\$400,000	Helicopter engines, rotors and spare parts
State Company for Automotive Industries	\$1,500,000	Welding machines, forklifts, semi-trailer axles, torches, and compressors
State Company for Cotton Industries	\$2,350,000	Cotton, drawing and bleaching machines, and generators
State Company for Design and Engineering Consultation	\$150,000	Engineering services
State Company for Drugs-Nineveh	\$1,000,000	Production line equipment and spare parts
State Company for Electrical Industries	\$625,000	Parts for air-conditioning assembly
State Company for Electronic Industries	\$500,000	Test equipment and spare parts for computer repair
State Company for Furniture-Baghdad	\$570,000	Plywood and forklift
State Company for Glass and Ceramic	\$935,000	Training and spare parts
State Company for Handmade Carpets	\$750,000	Various fabrics, sewing machines and computers

State Company for Heavy Equipment Engineering	\$1,743,610	Oxygen PSA generator, Computers and Auto CAD software, and generators
State Company for Industrial Design and Construction	\$150,000	Engineering services
State Company for Leather Industries	\$1,000,000	CNC Cutting machines, tanning equipment, and sheep skin machine
State Company for Mechanical Industries	\$5,693,742	Tractors, backhoes, tillers, and tools
State Company for Rubber Industries	\$2,160,785	Fuel oil burners, control panel, pipe, valves, flanges for water treatment system
State Company for Textiles-Hilla	\$2,000,000	Various yarns, and sewing equipment
State Company for Textiles-Wassit	\$1,350,000	Various yarns
State Company for Woollen Industries	\$2,000,000	Various fabrics, sewing machines, and forklift
Tikrit Flour	\$177,800	General operating expenses

Appendix C—Acronyms

DoD	Department of Defense
FY	Fiscal Year
GoI	Government of Iraq
JCC-I/A	Joint Contracting Command-Iraq/Afghanistan
MoIM	Ministry of Industry and Minerals
SIGIR	Special Inspector General for Iraq Reconstruction
SOE	State-owned Enterprise
Task Force	Task Force to Improve Business and Stability Operations

Appendix D—Audit Team Members

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

Ken Bowen

Ziad Buhaissi

Ben Comfort

Mike Kennedy

Appendix E – Management Comments



DEPARTMENT OF DEFENSE
Task Force to Support Business and Stability Operations in Iraq
Baghdad, Iraq
APO AE 09348



JAN 29 2009

To: Special Inspector General for Iraq Reconstruction

From: Deputy Under Secretary of Defense for Business Transformation
Director, Task Force to Improve Business and Stability Operations, Iraq

Subject: Response to SIGIR draft report 09-09, "Full Impact of Department of Defense Program to Restart State-Owned Enterprises Difficult to Estimate".

TFBSO acknowledges receipt of the subject draft and appreciates the opportunity to provide comment. We also appreciate the generally constructive nature of the audit, and the suggestions for improvement. I will limit my comments to two primary areas of focus for the audit, with the goal of contextualizing a fundamental concern with the methodology of the audit and its goals.

Response to Finding 1: Lack of Reliable Data and Performance Measures Make it Difficult to Fully Estimate Impact

In July of 2007, TFBSO received the first of two appropriations of \$50M from Congress for the purpose of restarting the idled Iraqi industrial base. This industrial revitalization effort, one of five key economic revitalization initiatives led by TFBSO, sought to rectify decisions taken in 2003 to shut down the largely state-owned industrial base of Iraq by the United States, in an effort promote rapid free market economic development. The goal of TFBSO efforts was to reverse this policy, to restart potentially viable industrial operations and restore normalcy and employment in local communities, and to transitionally privatize these operations.

From the beginning, our objective was to avoid overemphasizing restoration of employment by Directors General (Plant Managers) of these factories. In the past, these factories had too often served as welfare-state employment programs, hiring far more people than their revenue or production levels could justify. After over three years of idle employees, however, Multi National Force – Iraq commanders made clear that our objective, as an element of Counter Insurgency (COIN) Strategy, was to focus on rapid reemployment and prioritize our initial \$50M to focus on employment as its first objective.

Based upon this stabilization requirement, we based our initial investments on the best data available on where the greatest stabilization impact could be achieved by reemploying local idled workers. Our ability to spend time and money doing detailed “baselining” during the worst period of insurgent violence was very limited. Upon completion of the initial projects, we focused on the next set of factories for restarting operations, and on providing subsequent business training for factory managers in effective business planning, cost management, and achieving profitability.

The reported employment numbers SIGIR has focused on for the set of factories they audited were estimates based on conservative assumptions. They do not incorporate secondary or tertiary impacts on suppliers or customers, a key element of reemployment effects in any economic measurement exercise. Based on initial estimates, in which we saw about one third of workers on reduced payroll in idled factories return to work, I personally instructed my industrial revitalization team to apply a conservative similar reduction factor of one-third to any estimates of employment provided by factory managers, and not to spend time worrying about exact employment numbers. As SIGIR points out, our staff of six government employees and twenty eight contractors have worked to restart or increase production in over sixty large factories in Iraq to date. Our manning and resources available to retroactively audit exact current employment figures in factories where we have already completed our work, in communities that are now stable, is limited, and I would argue, of little value to the mission.

We remain confident our total employment impact estimates for our industrial revitalization efforts are overly conservative. The effect on the factories, their suppliers, their second tier suppliers, and their customers are not included in our estimates. We are acquiring the services of a professional accounting firm with the express purpose of auditing this entire 'value chain' impact of our efforts for all of the factories we have reopened in partnership with the Government of Iraq. The results of this audit will be provided to the SIGIR and to the public as soon as this work is completed during 2009.

In closing on this subject, we agree with the SIGIR statement that the "Full Impact ...is...Difficult to Measure". We believe this difficulty is positive. It was TFBSO that worked with the Ministry of Finance to increase the Ministry of Industry and Minerals budget from \$30M in 2007 to over \$500M in 2008, enabling the Iraqis to fund this effort going forward and eliminating our need to seek additional Congressional funds for this work in 2009. It was TFBSO that organized and sponsored conferences led by the Ministry of Industry and Minerals at which the formerly idled State Owned factories were offered for private investment. It was TFBSO accountants, engineers and consultants that assisted factories in preparing their business plans for review by investors at these conferences. And the impact of this effort is clear. In 2008, over \$900M in foreign private investment was secured in formerly idled state owned factories in Iraq (See Appendix A). Over \$1B in additional proposals are now in review by the Government of Iraq, which is soliciting investments for additional factories we have worked to restart in the past two years. In less than two years time, a small number of American managers, engineers, and accountants have rectified early US mistakes and set the industrial economy of Iraq on a path to viability, assisting in the stabilization efforts of our military forces. The positive impact, and the full (if difficult) measure, of our industrial revitalization efforts will be felt for years to come.

Response to Finding 2: Controls Over Disbursement Can be Improved

The draft report has a second finding in the area of disbursement controls. We understand the SIGIR's concern about this sensitive area, but want to offer some additional points for consideration.

One of several important disbursement controls is the collection of invoices from SOEs that have been directly paid to procure their own goods. Carefully managed procurement by the SOE helps build their skills and ability to execute procurements, while in some cases speeding up the procurement process and reducing the burden on US contracting staff in Iraq.

The draft report calls into question certain disbursement controls without appropriate regard to risk-mitigating controls already in place. The report does not recognize a complimentary or secondary control in this area. As reported to SIGIR, the Task Force procurement planning process directly and carefully supports the SOE procurements. The Task Force has put into place American engineers to plan the procurement for the SOEs before the funds are transferred, identifying the cost and specification of the equipment or material to be acquired with these funds. As a result, the amount of funds given to the SOE is based on real world estimates garnered from extensive research, planning, and subject matter expertise.

While the Task Force has had difficulty in a few cases collecting invoices from the factories for their purchases (specifically, in the case of purchased raw materials), the collection of the invoices can be considered a secondary control, and the risks associated with this part of the process are already being mitigated. SIGIR is justifiably seeking to minimize the possibility of inappropriate activity by a factory manager or staff member. But in the case of this concern, a paper invoice or receipt in Iraq is scarcely affirmation of physical delivery of equipment or material. Paper documents can be easily printed and forged. To address our own concerns about this sensitive matter, in every case, we physically verified receipt of material and/or equipment using our own personnel or (in the case of the Tikrit Flour Mill) Provincial Reconstruction Team staff, and documented this verification. The fact that a factory in a particular location failed to provide an invoice or receipt is a violation of process, but is not indicative of a lack of control given our diligence in managing and verifying project delivery.

In addition, SIGIR noted that there were two cash advances for general operating expenses made to two SOEs totaling \$229,400. The report discusses cash payments that were made to two SOEs; however, only one was for "general operating expenses." The \$52,000 that was paid to KRG Carpets was to procure raw materials needed to produce handmade carpets. The actual payment date was in June 2008 as the report suggests. However, it was made via EFT (Electronic Funds Transfer) in U.S. dollars not in cash as Iraqi Dinars.

In the case of Tikrit Flour, the funding was used by the Director General to pay operating expenses to open the factory. The fact that the factory did open and flour was produced, consuming wheat grown by local farms, (a bag of which was delivered to MNF-I Commanding General) is verification the funding was utilized for its intended purpose. The decision was made to transfer money directly to the SOE to support this effort so that the factory would remain open providing a viable business and vital lifeline to the community. The Tikrit Flour payments were made on September 5, 2007 (\$82,000), November 7, 2007 (\$68,000), and March 4, 2008 (\$27,400).

As a result of this project, the Task Force increased efforts to facilitate the use of EFT (and dedicated a team to this mission soon after). As a result, all SOEs involved in the grant program now work with EFT instead of cash. Simply put, the Task Force recognized the risk with this type of transaction early on and implemented appropriate policies and processes as a result.

Finally, the report notes that payments are made on U.S. contracts before verification of receipt of goods because “JCC-I processes invoices for payment as they are received and does not have procedure to check with the Task Force if the items have been received.” Once the receipt of the goods has been verified, a DD250 is completed by the Task Force. JCC-I and the Finance office perform a three-way check with the invoices and purchase orders before any payment is made. Because of this check, an environment exists where the vendor, the Task Force, and JCC-I must coordinate before payment of the invoice. Only in instances where JCC-I was contractually obligated to pay at the time of shipping or provide a 15% pre-payment to the vendor, was the Task Force not required to verify the receipt of goods before payments.

Conclusion

In all, we appreciate the recommendations made in the report. Based on the detailed discussions with SIGIR we are working to implement them. We are appreciative of the audit’s review and constructive assistance. We do believe the report falls short in acknowledging the environment that existed at the time the program was started, our conservative approach to establishing an estimate of jobs impacted for use in internal MNF-I reporting, the strong Validation and Verification procedures in place, and the impacts to the stabilization of Iraq the program has made. As with our private banking, agricultural development, foreign investment, and procurement assistance efforts, we believe our industrial revitalization project management and associated controls using professional accounting and audit firms exceed those applied by any other reconstruction effort in Iraq. Our discussions with SIGIR personnel have indicated that your organization shares this opinion. We look forward to continuing our positive engagement with SIGIR.



PAUL A. BRINKLEY

Deputy Under Secretary of Defense for Business Transformation
Director, Task Force to Improve Business and Stability Operations, Iraq

Attached: Appendix A

Appendix A: Private Investment in State Owned Factories as of 31 December 2008

State Owned Factory	Amount	Investor(s)	Date Completed
Completed Ventures			
Sinjar Cement	\$120 Million	International Firm	December 2008
Fallujah Cement	\$80 Million	International Firm	December 2008
Diyala Electric	\$80 Million	Egyptian Consortium	November 2008
Northern Fertilizer--Baiji	\$180 Million	Japanese Consortium	November 2008
Kubaysa Cement	\$150 Million	Japanese Consortium	November 2008
Kirkuk Cement	\$150 Million	German Consortium	May 2008
Al Qaim Cement	\$150 Million	Lebanese Consortium	May 2008

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