

January 2008

# IRAQ RECONSTRUCTION

## Better Data Needed to Assess Iraq's Budget Execution





Highlights of [GAO-08-153](#), a report to congressional committees

## Why GAO Did This Study

The President's New Way Forward in Iraq identified Iraq's inability to spend its resources to rebuild infrastructure and deliver essential services as a critical economic challenge to Iraq's self-reliance. Further, Iraq's ability to spend its \$10.1 billion capital projects budget in 2007 was one of the 18 benchmarks used to assess U.S. progress in stabilizing and rebuilding Iraq.

This report (1) examines data the U.S. embassy used to determine the extent to which the government of Iraq spent its 2007 capital projects budget, (2) identifies factors affecting the Iraqi government's ability to spend these funds, and (3) describes U.S. government efforts to assist the Iraqi government in spending its capital projects funds.

For this effort, GAO reviewed Iraqi government budget data and information on provincial spending collected by the U.S. Provincial Reconstruction Teams. GAO also interviewed officials from the departments of the Treasury, Defense, State, and other agencies and organizations.

## What GAO Recommends

We recommend that the Secretary of Treasury work with the government of Iraq and relevant U.S. agencies to enhance the department's ability to report accurate and reliable expenditure data from Iraq's ministries and provinces. Treasury agreed with our recommendation.

To view the full product, including the scope and methodology, click on [GAO-08-153](#). For more information, contact Joseph A. Christoff at (202) 512-8979 or [christoffj@gao.gov](mailto:christoffj@gao.gov).

# IRAQ RECONSTRUCTION

## Better Data Needed to Assess Iraq's Budget Execution

### What GAO Found

U.S. and Iraq reports show widely disparate rates for Iraqi government spending on capital projects. Accordingly, GAO cannot determine the extent to which the Iraqi government is spending its 2007 capital projects budget. In its September 2007 Iraqi benchmark assessment, the administration reported that Iraq's central government ministries had spent 24 percent of their 2007 capital projects budget, as of July 15, 2007. However, this report is not consistent with Iraq's official expenditure reports, which show that the central ministries had spent only 4.4 percent of their investment budget as of August 2007. The discrepancies between the official and unofficial data highlight uncertainties about the sources and use of Iraq's expenditure data.

The government of Iraq faces many challenges that limit its ability to spend its capital project budget. Violence and sectarian strife delay capital budget execution by increasing the time and cost needed to implement contracts. Recent refugee flows and the de-Ba'athification process have contributed to the exodus of skilled labor from Iraq. In addition, U.S. and foreign officials also noted that weaknesses in Iraqi procurement, budgeting, and accounting procedures impede completion of capital projects. For example, according to the State Department, Iraq's Contracting Committee requires about a dozen signatures to approve projects exceeding \$10 million, which slows the process.

U.S. agencies have undertaken a variety of programs to help Iraq execute its capital projects budget, although it is not clear what impact these efforts have had to date. U.S. agencies supported new efforts in 2007 targeting Iraq's ability to spend capital budget funds, including an office to provide procurement assistance to ministries and provinces and a new position in the U.S. Embassy to coordinate with senior Iraqi government officials on budget execution and oversee related U.S. assistance efforts. In addition, improving Iraqi government budget execution is part of a broader U.S. assistance effort to improve the capacity of the Iraqi government. For example, the U.S. Agency for International Development (USAID) has trained 500 ministry officials in procurement or budget execution. USAID also led an effort to implement an automated financial management information system for the Iraqi government, although this program was suspended in June 2007 following the kidnapping of five contractors involved in the project. In addition, U.S. advisors work directly with key Iraqi ministries to assist with budget execution and procurement, among other responsibilities.

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## Abbreviations

|         |   |
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| CPA     | Coalition Provisional Authority                   |
| DOD     | Department of Defense                             |
| IFMIS   | Iraqi Financial Management Information System     |
| IMF     | International Monetary Fund                       |
| IRMO    | Iraq Reconstruction Management Office             |
| ITAO    | Embassy Iraq Transition Assistance Office         |
| MNSTC-I | Multinational Security Transition Command-Iraq    |
| PRT     | Provincial Reconstruction Team                    |
| SIGIR   | Special Inspector General for Iraq Reconstruction |
| USAID   | U.S. Agency for International Development         |

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United States Government Accountability Office  
Washington, DC 20548

January 15, 2008

Congressional Committees:

The President's February 2007 New Way Forward strategy for Iraq identified Iraq's inability to spend its resources to rebuild infrastructure and deliver essential services as a critical economic challenge to Iraq's self-reliance. Further, the allocation and expenditure of Iraq's \$10.1 billion capital projects budget in 2007 was 1 of the 18 benchmarks used to assess U.S. progress in stabilizing and rebuilding Iraq.<sup>1</sup> Iraqi government funds are a necessary source of financing for Iraq's rebuilding effort, particularly because the United States has obligated most of the \$40 billion it has provided to Iraq for reconstruction since 2003. However, the government of Iraq has had difficulty spending its resources on capital projects.

This report (1) examines data used by the U.S. embassy in Baghdad to determine the extent to which the government of Iraq has spent its \$10.1 billion capital projects budget for 2007, (2) identifies factors affecting the Iraqi government's ability to spend these funds, and (3) describes U.S. government efforts to assist the Iraqi government in spending its capital projects funds.

To address these objectives, we analyzed reports and interviewed officials in Washington, D.C., and Baghdad from the departments of State (State), Defense (DOD), and the Treasury (Treasury); the U.S. Agency for International Development (USAID); the Economic Affairs Section of the U.S. Embassy in Baghdad; and consultants under contract with the United Kingdom's Department of International Development. We reviewed Iraqi Ministry of Finance capital projects budget and expenditure data for fiscal years 2006 and 2007, which were provided by Treasury and the U.S. Embassy in Baghdad. We also reviewed information on provincial spending collected by the U.S. Provincial Reconstruction Teams (PRT) and reported by the U.S. Embassy in Baghdad. We conducted this performance audit from April 2007 through December 2007 in accordance with generally accepted government auditing standards. Those standards

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<sup>1</sup>GAO, *Securing, Stabilizing, and Rebuilding Iraq: Iraqi Government Has Not Met Most Legislative, Security, and Economic Benchmarks*, [GAO-07-1195](#) (Washington, D.C.: Sept. 4, 2007).

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require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. A detailed description of our scope and methodology is included in appendix I of this report. Due to broad congressional interest in this issue, we performed our work under the authority of the Comptroller General of the United States to conduct reviews on his own initiative.

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## Results in Brief

U.S. and Iraq reports show widely disparate rates for Iraqi government spending on capital projects. Accordingly, we cannot determine the extent to which the Iraqi government is spending its 2007 \$10.1 billion capital projects budget. In its September 2007 progress report on Iraqi benchmarks, the administration stated that Iraq's central government ministries had spent 24 percent of their 2007 capital projects budget, as of July 15, 2007. The report concluded that, compared with 2006, the government of Iraq was becoming more effective in spending its capital projects budget. However, the administration's report is not consistent with Iraq's official expenditure reports, which show that the central ministries had spent only 4.4 percent of their investment budget, as of August 2007.<sup>2</sup> The discrepancies between the official and unofficial data highlight uncertainties about the sources and use of Iraq's expenditure data.

The government of Iraq faces many challenges that limit its ability to spend its capital project budget. First, Treasury officials noted that violence and sectarian strife delay capital budget execution by increasing the time and cost needed to award and monitor contracts, and by reducing the number of contractors willing to bid on projects. Second, these officials stated that recent refugee outflows and the de-Ba'athification process have reduced the number of skilled workers available and contributed to the exodus of these workers from Iraq. Third, U.S. and foreign officials also noted that weaknesses in Iraqi procurement, budgeting, and accounting procedures impede completion of capital

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<sup>2</sup>Iraq's investment budget consists primarily of capital projects. The 2007 Iraq budget has separate categories for capital goods and capital projects. However, in 2007, Iraq's ministries started reporting these expenditures under a single category, "nonfinancial assets," which we refer to as "investment" for the purpose of this report (with capital projects representing almost 90 percent of the investment budget).

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projects. For example, according to the State Department, Iraq's Contracting Committee requires about a dozen signatures to approve projects exceeding \$10 million, which slows the process.

U.S. agencies have undertaken a variety of programs to help Iraq execute its capital projects budget, although it is not clear what impact these efforts have had to date. U.S. assistance established in early 2007 that specifically targets Iraqi budget execution includes a procurement assistance office, which offers technical assistance to ministries and provinces, and a Coordinator for Economic Transition position in the U.S. Embassy, who met regularly with senior Iraqi government officials on matters related to budget execution and oversaw related U.S. assistance efforts. In addition, improving Iraqi government budget execution is part of a broader U.S. assistance effort to improve the capacity of the Iraqi government. For example, USAID has trained 500 ministry officials in procurement or budget execution. USAID also led the effort to implement an automated financial management information system for the government of Iraq, although this program was suspended in June 2007 following the kidnapping of five contractors involved in the project. U.S. advisors also work directly with key Iraqi ministries to assist with budget execution and procurement, among other responsibilities. It is difficult to determine the impact of these efforts on the capacity of the government of Iraq to spend its capital projects budget, given the limitations with available data, and because new programs specifically designed to improve Iraq's budget execution were established too recently for U.S. agencies to evaluate them.

We recommend that the Secretary of Treasury work with the government of Iraq and relevant U.S. agencies to enhance the department's ability to report accurate and reliable expenditure data from the ministries and provinces. Treasury agreed with our recommendation.

In commenting on a draft of this report, Treasury and State raised several concerns. First, Treasury stated that our analysis of Iraq's budget execution was based on incomplete and unofficial reporting, in particular, the data that the administration used in its September 2007 Benchmark Assessment Report to Congress. We agree that the unofficial data that the administration used in the report to Congress do not portray a full and accurate picture of the situation. Accordingly, we compared these data with official Ministry of Finance data to assess the extent to which the Iraqis had spent their capital projects budget. Since the spending gap between the administration's unofficial data and the Ministry of Finance's

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official data is strikingly large, we recommend that the Department of Treasury work with the Ministry of Finance to reconcile these differences.

Second, Treasury stated that our report incorrectly concluded that capital spending is only contained in the Iraqi budget item for “nonfinancial assets” (which we refer to as “investment”). State made a similar comment. Treasury and State asserted that capital spending is spread through many chapters in the new chart of accounts and that the amount is higher than the 4.4 percent cited in our report. However, State and Treasury did not provide us with evidence to demonstrate which Iraqi accounts included additional capital expenditures.

State also commented that the draft report failed to accurately portray the “tangible progress” that the central and provincial governments have made in budget execution. However, we do not believe the data are sufficiently reliable to conclude that U.S. assistance efforts have already achieved significant success helping the Iraqi government execute its capital budget.

In addition, State attributed the discrepancy between the official and unofficial data cited in our report to “a time lag in data collection” and asserted that the July 15 data were representative of the government of Iraq’s budget performance. After we provided our draft report to State for comment, we received updated data from Treasury that clearly refutes State’s comment. These updated data show that the central ministries spent 4.4 percent of their investment budget through August 2007, raising questions about the unofficial data reported to Congress in the administration’s September 2007 benchmark report.

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## Background

The United States, along with its coalition partners and various international organizations and donors, have made significant efforts to rebuild Iraq’s infrastructure and the capacity of its personnel. The United States alone has provided more than \$40 billion since 2003, most of which has been obligated. The February 2007 U.S. strategy, *The New Way Forward in Iraq*, emphasizes a transition of responsibility for reconstruction to the Iraqi government.

Iraq’s national government was established after a constitutional referendum in October 2005, followed by election of the first Council of Representatives (Parliament) in December 2005, and the selection of the first Prime Minister, Nuri Kamal al-Maliki, in May 2006. By mid-2006, the cabinet was approved; the government now has 34 ministries responsible

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for providing security and essential services—including electricity, water, and education—for the Iraqi people.

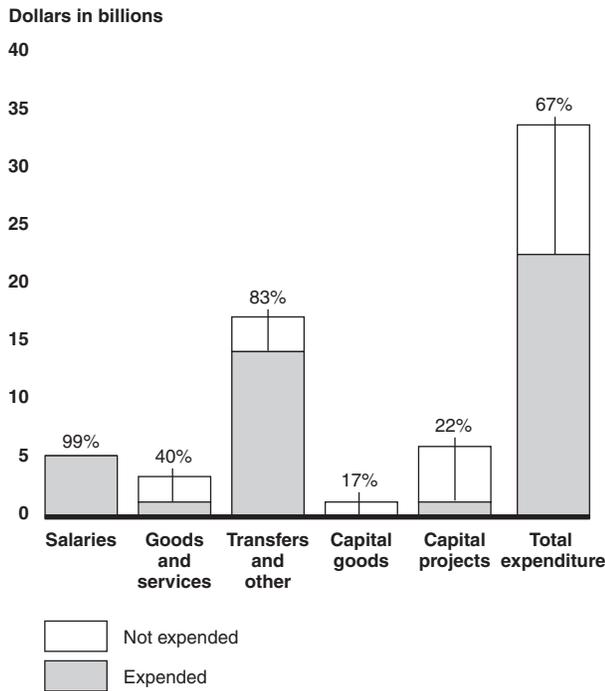
Iraq's Ministry of Finance plays the key role in developing, analyzing, and executing the budget, including distributing funds to individual spending units, and preparing periodic financial reports. Iraq's financial management law directs the Ministry of Finance to consult with the Ministry of Planning and Development Cooperation in establishing budget funding priorities. Individual Iraqi spending units in the 34 central government ministries, the 15 provinces, and the Kurdistan region provide expenditure estimates to the Ministry of Finance. The Ministry of Finance, in consultation with the Ministry of Planning, uses this information to develop the budget and submits the draft budget to the Council of Ministers for approval before submitting it to the National Assembly for final approval. The Ministry of Planning is responsible for centralized project management support, including review and analysis of capital project plans and monitoring of contractor performance.

As we reported in September 2007,<sup>3</sup> the government of Iraq spent only 22 percent of its \$6.2 billion capital projects budget in 2006 for the central government and Kurdistan (see fig. 1). The provinces received about \$2 billion in 2006 funds for infrastructure and reconstruction projects, but these funds were included in the budget as transfers, rather than as part of the capital projects budget.

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<sup>3</sup>[GAO-07-1195](#).

**Figure 1: Iraq's 2006 Budget Expenditures**



Source: GAO analysis of government of Iraq budget data as reported by the U.S. Treasury.

## Extent of Iraqi Capital Project Spending in 2007 Cannot Be Determined Due to Conflicting Data

The government of Iraq's fiscal year 2007 budget allocates \$10.1 billion for capital projects, including \$6.4 billion for use by central government ministries, \$2.1 billion for use by the provinces, and \$1.6 billion for use by the semiautonomous Kurdistan region.<sup>4</sup> However, we cannot determine the extent to which Iraq has spent these funds due to conflicting expenditure data. The U.S. government's September 2007 benchmark report,<sup>5</sup> citing unofficial Ministry of Finance data, stated that Iraqi ministries had spent 24 percent of their capital projects budgets, as of July 15, 2007. However, according to official Ministry of Finance expenditure data, Iraqi ministries had spent only 4.4 percent of their budgets for

<sup>4</sup>According to Section 9 of Iraq's Financial Management law, "funds approved for spending units may be used only until December 31st of the fiscal year, except to the extent that goods and services have been validly ordered and received."

<sup>5</sup>The White House, *Benchmark Assessment Report*, Sept. 14, 2007.

“nonfinancial assets,” or investment, as of August 31, 2007. Capital projects represent almost 90 percent of the investment budget, which combines capital projects and capital goods. In addition, the administration has relied on unofficial PRT data to track the provinces’ spending on capital projects and has reported the level of funds that the provinces have committed to projects as an indicator of spending.<sup>6</sup> However, provinces had spent only 12 percent of their 2007 funds, as of October 2007, according to PRT reporting.

### U.S. and Iraqi Reports Show Differing Spending Rates

Citing unofficial Ministry of Finance data, the administration’s September 2007 Benchmark Assessment Report stated that the Iraqi ministries had spent 24 percent of their capital projects budgets, as of July 15, 2007. The report concluded from these data that the government of Iraq is becoming more effective compared with 2006 in spending its capital projects budget. However, the unofficial data on percent of budget spent are significantly higher than official Iraqi expenditure data indicate. According to official reporting by the Ministry of Finance, as of August 31, 2007, Iraqi ministries spent only 4.4 percent of their 2007 investment budget (most of which is for capital projects). Table 1 compares the two sets of data.

**Table 1: Capital Projects Budget, Unofficial and Official Data on Expenditures for Five Iraqi Ministries with Largest Capital Budgets and for Provinces, Fiscal Year 2007**

Dollars in millions

| Ministry/spending unit                      | 2007 capital projects budget | Capital projects expenditures as of July 15, 2007 (unofficial data) <sup>a</sup> |  | Investment expenditures through August 2007 (official data) <sup>b</sup> |                         |
|---|------------------------------|--|--|--|-------------------------|
|   |                              | Amount spent   | As percentage of capital projects budget | Amount spent   | As percentage of budget |
| Ministry of Oil                             | \$2,381                      | \$500  | 21%                                      | \$0.27   | 0.01%                   |
| Ministry of Electricity                     | 1,385                        | 354  | 26                                       | 0.05   | 0.004                   |
| Ministry of Municipalities and Public Works | 338                          | 196  | 58                                       | 102  | 30.2                    |
| Ministry of Health                          | 342                          | 11   | 3  | 30   | 7.8                     |

<sup>6</sup>While PRTs’ separate reporting of provincial expenditures includes the level of funds committed by provinces, Ministry of Finance expenditure data do not include commitments. Commitments are defined under Iraq’s Financial Management Law, as “an undertaking to make an expenditure following the conclusion of a binding agreement that will result in a payment.”

Dollars in millions

| Ministry/spending unit             | 2007 capital projects budget | Capital projects expenditures as of July 15, 2007 (unofficial data) <sup>a</sup> |  | Investment expenditures through August 2007 (official data) <sup>b</sup> |                         |
|------------------------------------|------------------------------|--|--|--|-------------------------|
|                                    |                              | Amount spent   | As percentage of capital projects budget | Amount spent   | As percentage of budget |
| Ministry of Housing & Construction | 335                          | 79   | 24                                       | 34   | 10.0                    |
| Other spending units               | 1,641                        | 396  | 24                                       | 170  | 6.2                     |
| Subtotal for central government    | 6,421                        | 1,536  | 24                                       | 337  | 4.4                     |
| Provinces <sup>c</sup>             | 2,071                        | NA   | NA                                       | 2  | 0.09%                   |
| Kurdistan region                   | 1,560                        | NA   | NA                                       | 255  | 15.0                    |
| <b>Total capital budget</b>        | <b>\$10,052</b>              | <b>NA</b>  | <b>NA</b>                                | <b>594</b>   | <b>5.2%</b>             |

Source: GAO analysis of unofficial Iraq Ministry of Finance expenditure data through July 15, 2007, and Ministry of Finance official data through August 31, 2007, provided by the U.S. Department of the Treasury.

Note: Totals may be different due to rounding.

<sup>a</sup>The unofficial July 15, 2007 data do not break out provincial expenditures.

<sup>b</sup>Official expenditure data are subject to a verification process by the Ministry of Finance, according to a Treasury official. Treasury officials stated that, for 2007, ministries are reporting capital projects expenditures together with capital goods expenditures as part of a single budget category for investment. The 2007 budget for investment is the sum of the budgets for capital goods (\$1.3 billion) and capital projects (\$1.1 billion).

<sup>c</sup>This allocation of \$2,071 million is for “agencies not linked to a ministry.” Of this amount, the provinces were allocated \$2,067 million, with the remainder allocated to other agencies.

Although the 2007 Iraq budget has separate categories for capital goods and capital projects, the Iraqi government’s official expenditure data do not break out capital projects expenditures separately in 2007. To comply with new International Monetary Fund (IMF) budget classification requirements in 2007, the Iraqi government reports capital expenditures together under the heading of “nonfinancial assets,” which we refer to as investment in table 1.<sup>7</sup> Capital projects represent almost 90 percent of the investment budget, combining capital projects and capital goods. Appendix II provides further analysis of 2007 Ministry of Finance expenditure data and comparable 2006 data.

<sup>7</sup>To achieve debt restructuring, Iraq agreed to implement IMF conditions that stipulate specific economic reforms and milestones that the government needs to meet. These conditions are contained in the IMF stand-by arrangement, which was approved in December 2005, and in subsequent IMF reviews of the stand-by arrangement. The conditions include adoption of a government budget classification system and chart of accounts in line with IMF standards.

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In reviewing our draft report, Treasury officials stated that our official figure of 4.4 percent excluded capital project spending found in other budget categories. However, Treasury could provide no documentation that would allow us to verify whether, or the extent to which this occurs. State Department made similar comments in reviewing our report. However, State was unable to provide us with supporting documentation and referred us to the Department of Treasury. Also, Treasury officials noted that the higher figure of 24 percent capital project spending could include commitments in addition to actual expenditures.

The Ministry of Oil represents the largest share (24 percent) of the Iraqi government's capital projects budget in 2007. According to the unofficial data reported by the U.S. administration, as of July 15, 2007, the Ministry of Oil spent \$500 million on capital projects, which is 21 percent of the ministry's \$2.4 billion capital projects budget. This reported level of spending has already surpassed the ministry's total for 2006; however, it is not consistent with the much lower level of spending reflected in official Ministry of Finance data through August (see table 1). According to the Special Inspector General for Iraq Reconstruction (SIGIR), U.S. officials stated that the ministry may not have spent all of these funds but instead shifted them to subsidiaries such as the State Oil Marketing Organization, which have responsibility for spending much of the oil ministry's capital projects budget.<sup>8</sup>

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## U.S. Administration Relies on Unofficial PRT Data to Track Provincial Spending

The Iraqi government provided \$2.1 billion, or over 20 percent of the 2007 capital projects budget, to the provinces (not including the semiautonomous Kurdistan region), in amounts proportional to their populations. These funds are in addition to approximately \$2 billion in 2006 provincial funds, most of which had not been transferred to the provinces until November and December of 2006. Because of the late transfer, the provinces were permitted to carry over unspent 2006 funds.<sup>9</sup> Additionally, the semiautonomous Kurdistan region received a separate

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<sup>8</sup>SIGIR, *Quarterly Report and Semiannual Report to the United States Congress* (Arlington, VA: July 30, 2007).

<sup>9</sup>The approximately \$2 billion in 2006 capital projects funds for the provinces did not include the Kurdistan region, which received a separate allocation of \$500 million from the government of Iraq for capital projects in 2006. The government of Iraq permitted the provinces to carry over an estimated \$1.3 billion in unspent 2006 funds. Unspent 2007 capital funds for the provinces may not be carried over, according to U.S. officials.

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2007 budget allocation of \$1.6 billion, or 16 percent of the total 2007 capital projects budget.

To track capital projects budget execution by the provinces, the administration uses unofficial commitment and expenditure information collected by PRTs.<sup>10</sup> The administration's September 2007 benchmark report cited PRT commitment data as an indicator of successful budget execution by the provinces. The September report stated that provinces committed almost half of their 2007 capital projects budgets. However, the extent to which committed funds indicate actual spending is unknown. Given the capacity and security challenges currently facing Iraq, many committed contracts may not be executed and would not result in actual expenditures, according to U.S. agency officials. According to PRT reporting, the provinces committed 58 percent of their 2007 budget but had spent only 12 percent as of October 21, 2007.<sup>11</sup> (For additional analysis of PRT data, see app. III.) U.S. officials noted that the provinces are still spending the 2006 funds they were permitted to carry over, which contributes to the low expenditure rate in 2007. Ultimately, actual spending by the provinces should be reflected in official 2007 expenditure data reported by the Ministry of Finance.

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## The Government of Iraq Faces Many Challenges in Attempting to Spend Its Capital Projects Budget

U.S. government, coalition, and international agencies have identified a number of factors that challenge the Iraqi government's efforts to fully spend its budget for capital projects. First, Treasury officials noted that violence and sectarian strife can delay capital budget execution by increasing the time and cost needed to award and monitor contracts, and by reducing the number of contractors willing to bid on projects. Second, these officials stated that recent refugee outflows and the de-Ba'athification process have reduced the number of skilled workers available and contributed to the exodus of Iraq's professional class from the country. Third, U.S. and foreign officials also noted that weaknesses in Iraqi procurement, budgeting, and accounting procedures impede completion of capital projects.

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<sup>10</sup>PRTs are joint civil-military units formed in fall 2005 to help improve provincial governance, including assistance with budget formulation and execution.

<sup>11</sup>This 12 percent figure includes a small portion of the Kurdistan region's separate capital projects budget allocation.

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## Violence and Sectarian Strife Hinder Budget Execution for Capital Projects

U.S., coalition, and international officials noted that violence and sectarian strife remain major obstacles to developing Iraqi government capacity, including its ability to execute budgets for capital projects. The high level of violence has contributed to a decrease in the number of workers available and can increase the amount of time needed to plan and complete capital projects. The security situation also hinders U.S. advisors' ability to provide the ministries with assistance and monitor capital project performance.

Violence and sectarian strife have reduced the pool of available talent to budget and complete capital projects and, in many cases, have increased the time needed to complete projects. International officials noted that about half of Iraqi government employees are absent from work daily; at some ministries, those who do show up only work between 2 to 3 hours per day for security reasons. U.S. and UN officials stated that, while the Ministry of Planning has a relatively skilled workforce, the security situation seriously hinders its ability to operate. These officials noted that 20 director generals (department heads or other senior officials) in the ministry have been kidnapped, murdered, or forced to leave the ministry in the 6 months prior to February 2007.

Numerous U.S. and coalition officials also stated that security concerns delay the ability of advisors to provide assistance, noting that it is often too dangerous for staff to provide training or monitor contract performance. The high level of violence hinders U.S. advisors' access to their counterparts in the ministries and directly affects the ability of ministry employees to perform their work. State and USAID efforts are affected by the U.S. embassy restrictions imposed on their movement. Embassy security rules limits, and in some cases bars, U.S. civilian advisors from visiting the ministries outside the Green Zone. For example, a former Treasury attaché noted that his team could not visit the Ministry of Finance outside the Green Zone and thus had limited contact with ministry officials. Further, USAID suspended efforts to complete the installation of the Iraqi Financial Management Information System (IFMIS) in May 2007 after five British contractors were kidnapped from the Ministry of Finance.

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## Lack of Trained Personnel Hinders Capital Project Budgeting and Execution

U.S., coalition, and international agency officials have observed the relative shortage of trained budgetary, procurement, and other staff with technical skills as a factor limiting the Iraqis' ability to plan and execute their capital spending. The security situation and the de-Ba'athification process have adversely affected available government and contractor

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staffing. Officials report a shortage of trained staff with budgetary experience to prepare and execute budgets and a shortage of staff with procurement expertise to solicit, award, and oversee capital projects. According to State and other U.S. government reports and officials, there has been decay for years in core functions of Iraq's government capacity, including both financial and human resource management.

Officials also state that today's unsafe environment has resulted in a large percentage of Iraq's more skilled citizens leaving the country. According to a UN report, between March 2003 and June 2007, about 2.2 million Iraqis left the country, and about 2 million were internally displaced. The UN also has estimated that at least 40 percent of Iraq's professional class has left the country since 2003. One Iraqi official complained that those leaving the country tend to be from the educated and professional classes. As a result, fewer skilled Iraqi workers outside the government are available to bid on, design, and complete proposed capital projects.

Further, a 2006 Department of Defense (DOD) report stated that Iraq's government also confronts significant challenges in staffing a nonpartisan civil service and addressing militia infiltration of key ministries. The report noted that government ministries and budgets are sources of power for political parties, which staff ministry positions with party cronies as a reward for political loyalty.<sup>12</sup> Some Iraqi ministries under the authority of political parties hostile to U.S. goals use their positions to pursue partisan agendas that conflict with the goal of building a government that represents all ethnic groups. For example, until late April 2007, the Ministries of Agriculture, Health, Civil Society, Transportation, Governorate Affairs, and Tourism provided limited access to U.S. officials, as they were led by ministers loyal to Muqtada al-Sadr, who has been hostile to U.S. goals.

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## Procurement, Budgetary, and Accounting Weaknesses Impair Capital Budget Execution

Weak procurement, budgetary, and accounting systems are of particular concern in Iraq because these systems must balance efficient execution of capital projects while protecting against reported widespread corruption. A 2006 survey of perceptions of corruption by Transparency International ranked Iraq's government as one of the most corrupt in the world.<sup>13</sup> A

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<sup>12</sup>DOD, *Measuring Stability and Security in Iraq: Report to Congress in Accordance with the Department of Defense Appropriations Act 2007, Section 9010, Public Law 109-289* (Washington, D.C.: November 2006).

<sup>13</sup>Transparency International, *Annual Report 2006*.

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World Bank report notes that corruption undermines the Iraqi governments' ability to make effective use of current reconstruction assistance.<sup>14</sup> According to a State Department document, widespread corruption undermines efforts to develop the government's capacity by robbing it of needed resources, some of which are used to fund insurgency; by eroding popular faith in democratic institutions, perceived as run by corrupt political elites; and by spurring capital flight and reducing economic growth.

U.S. and international officials have cited many weaknesses in Iraqi procurement procedures and practices. The World Bank found that Iraq's procurement procedures and practices are not in line with generally accepted public procurement practices, such as effective bid protest mechanisms and transparency on final contract awards. Iraqi procurement laws and regulations are composed of a mixture of Saddam Hussein-era rules, CPA Order 87 requirements,<sup>15</sup> and recent Iraqi government budgetary practices. The complexity of Iraq's contracting regulations combined with the inexperience of many new Iraqi officials has led to a pervasive lack of understanding of these laws and regulations, according to State officials. The Iraqi government has sponsored conferences on budget execution in 2007 to clarify budgeting and procurement rules and procedures and issued regulations for implementing Order 87. However, laws and regulations are still complex and are frequently confusing to implement in practice, according to a Treasury official.

U.S., coalition, and international officials have identified difficulties in complying with Iraqi procurement laws and regulations as a major impediment to spending Iraqi capital project budgets. For example, according to an Iraq Reconstruction Management Office (IRMO)<sup>16</sup> official, the Iraqi procurement process often requires a minimum of three bids through a competitive bidding process. However, when less than three technically qualified bids are received, all bids are thrown out and the project cycles through a new round of bidding. The result has been fewer bids submitted in subsequent rounds. In addition, Iraqi procurement regulations require about a dozen signatures to approve oil and electricity

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<sup>14</sup>World Bank, *Rebuilding Iraq: Economic Reform and Transition*, February 2006.

<sup>15</sup>CPA Order 87 outlines requirements for public contracts in Iraq.

<sup>16</sup>On May 9, 2007, a presidential order created the Iraq Transition Assistance Office (ITAO) as the successor organization to IRMO.

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contracts exceeding \$10 million, which also slows the process, according to U.S. officials. Procurements over this amount must be approved by the High Contracting Commission, chaired by the Deputy Prime Minister, which causes further delays. U.S. advisors to the Ministry of Oil noted that the \$10 million threshold is far too low, given the size of infrastructure projects in the energy sector. In June 2007, the Council of Ministers raised the dollar thresholds for contracts requiring High Contracting Commission approval from \$10 million to \$20 million for the Ministries of Defense, Electricity, Oil, and Trade, and raised the level from \$5 million to \$10 million for other ministries. However, the embassy noted that the increased thresholds may not improve budget execution without an increase in the number of trained personnel or technical assistance from the Ministry of Planning.

Other features in the Iraqi budgetary and accounting systems adversely affect the tracking of capital projects spending. For example, government spending on reconstruction projects is not coordinated with spending for donor-financed projects, according to the World Bank. As a result, significant donor-financed expenditures are not included in the budget. In addition, according to U.S. officials, the budget is appropriated and tracked at too high a level of aggregation to allow meaningful tracking of decisions because multiple projects can be combined on a single line. Reconciliation of budget accounts is often impossible as budget execution reports are submitted late or with incomplete information. In addition, as discussed earlier, in response to IMF requirements, the government of Iraq began implementing a new budget classification and chart of accounts in 2007 that does not provide a separate breakout of capital projects spending. Appendix II provides further analysis of 2007 Ministry of Finance expenditure data and comparable 2006 data.

U.S. agencies, the World Bank, and independent auditors have reported a number of serious internal control weaknesses in Iraqi government accounting procedures. U.S. officials reported that the government of Iraq uses a manual reporting system to audit expenditures, which does not provide for real-time reports. According to a Treasury official, the Iraqi government reports capital expenditures by ministry but not by specific project, which limits its ability to track capital projects expenditures. The World Bank reported that reconciliation of government of Iraq accounts is impossible because the government lacks consolidated information on the exact number of government bank accounts it has and the balances in

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them. The World Bank also noted that provincial governments do not provide an accounting of funds they receive. In addition, the independent public accounting firm for the Development Fund for Iraq<sup>17</sup> reported numerous internal control weaknesses in Iraqi ministries for 2006, including that Iraqi ministries do not have policies and procedures manuals that detail comprehensive financial and internal controls. It also reported that the ministries do not have unified procurement policies and procedures, do not have proper project management and monitoring systems, and lack written project management policies and procedures manuals. Finally, the firm noted that the ministries' internal audit departments do not cover the operations of state-owned companies and entities that are related to the ministries and that there are no proper monitoring procedures over the operations of the related companies.

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## Several U.S. Assistance Efforts Are Under Way to Improve Iraqi Budget Execution

In early 2007, U.S. agencies increased the focus of their assistance efforts on improving the Iraqi government's ability to effectively execute its budget for capital projects, although it is not clear what impact this increased focus has had, given the inconsistent expenditure data presented earlier in this report. Several new U.S. initiatives were established targeting Iraqi budget execution, including coordination between the U.S. embassy and an Iraqi task force on budget execution, and the provision of subject-matter experts to help the government track expenditures and to provide technical assistance with procurement. According to U.S. officials, these targeted efforts also reflect an increased interest of senior Iraqi officials in improving capital budget spending. In addition, improving Iraqi government budget execution is part of a broader U.S. assistance effort aimed at improving the capacity of the Iraqi government through automation of the financial management system, training, and advisors embedded with ministries.

We recently reported on U.S. efforts to build the capacity of Iraqi ministries led by State, DOD, and USAID.<sup>18</sup> The findings and

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<sup>17</sup>United Nations Security Council Resolution 1483 noted the establishment of the Development Fund for Iraq (DFI). The DFI holds the proceeds of petroleum export sales from Iraq, as well as remaining balances from the UN Oil-for-Food Program and other frozen Iraqi funds. Disbursements from the Development Fund for Iraq must be used for the benefit of the Iraqi people.

<sup>18</sup>See GAO, *Stabilizing and Rebuilding Iraq: U.S. Ministry Capacity Development Efforts Need an Overall Integrated Strategy to Guide Efforts and Manage Risk*, [GAO-08-117](#) (Washington, D.C.: Oct. 1, 2007).

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recommendations from that report also apply to assistance efforts targeting Iraqi Budget Execution, which are a part of U.S. capacity-building efforts. Our report found that U.S. capacity building efforts in Iraq faced several challenges that posed risks to their success. The report also found that U.S. agencies implementing capacity development projects have not developed performance measures for all of their efforts, particularly outcome-related performance measures that would allow them to determine whether U.S. efforts at the civilian ministries have achieved both U.S.- and Iraqi-desired goals and objectives.<sup>19</sup> The report recommended that State, in consultation with the Iraqi government, complete an overall capacity-building strategy that includes plans to address risks and performance measures based on outcome metrics.

In early 2007, U.S. agencies began providing technical assistance and coordination specifically targeted to addressing Iraq's capital budget expenditure bottlenecks. This assistance includes the following:

- *Coordinator for Economic Transition in Iraq.* State established this position in the U.S. Embassy in February 2007 to work with senior Iraqi government officials and to coordinate with U.S. agencies that provide assistance related to improving Iraq's budget execution. The coordinator participated in regular meetings of an Iraqi government budget execution task force, which includes the Deputy Prime Minister and the Ministers of Finance and Planning, to address impediments to spending the government's capital projects budget. The coordinator also worked with the U.S. Treasury attaché to help the Iraqi government hold conferences on budget execution to educate government officials about Iraqi budget and procurement processes. According to a State official, the responsibilities of this position were transferred to Ambassador Charles Reis in June 2007, when he assumed responsibility for coordinating all economic and assistance operations in the Embassy.
- *Budget Execution Monitoring Unit.* The Iraq Reconstruction Management Office supported the creation of this unit in the Deputy Prime Minister's office with four to six subject-matter experts to help assess budget execution by collecting and aggregating spending data for key ministries and provinces. The unit was established in spring 2007. State officials

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<sup>19</sup>The World Bank defines *outputs* as the short-term achievements that result from activities undertaken to implement a program (e.g., the number of public servants trained). *Outcomes* are the medium term changes that result from achieving the outputs (e.g., the improved skills of employees). *Impacts* are the long-term changes that result over time from achieving the program's outputs and outcomes (e.g., improved program delivery).

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noted that the Budget Execution Monitoring Unit tracks aggregate spending by ministry. Although some ministries have demonstrated some capability to track what projects are undertaken with capital projects spending, the U.S. Embassy does not have a mechanism to track the results of capital projects spending across all ministries and provinces, according to State officials. Embassy officials and the Treasury Attaché are analyzing how to help Iraqi ministries and provinces develop project tracking tools.

- *Procurement Assistance Program.* State and DOD provided funding for 10 to 12 international subject-matter experts to support this program within the Ministry of Planning and Development Cooperation to help ministries and provinces with procurement and capital budget execution, including policy interpretation, training, acquisition consulting, and technical assistance. The program was established in May 2007 and consists of two Procurement Assistance Centers in Baghdad and one in Erbil. The program is currently setting up 18 Provincial Procurement Assistance Teams that will provide direct assistance to provincial officials.

In addition to these recently established efforts, which are specifically designed to help the Iraqi government execute its capital projects budget, several broader, ongoing capacity-building assistance efforts are under way. These efforts include assistance related to budget execution, although that is not their primary focus. These efforts include the following:

- *Iraqi Financial Management Information System (IFMIS).* USAID and IRMO awarded contracts beginning in 2003 to BearingPoint to install a Web-based financial management information system for the government of Iraq to support a fully automated and integrated budget planning and expenditure reporting and tracking system at the central and provincial levels.<sup>20</sup> The IMF has highlighted the importance of implementing IFMIS in its reviews of Iraq's progress toward meeting the terms of the IMF Standby Agreement. However, according to USAID officials, the project experienced significant delays, due in part to a lack of full support by Iraqi government officials. USAID suspended assistance to the Ministry of Finance to implement IFMIS in June 2007, following the kidnapping of five BearingPoint employees. A USAID official stated that the Iraqi government continues to rely on its legacy manual accounting system, which

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<sup>20</sup>DOD has a separate contract to install this system for the Ministries of Defense and Interior.

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contributes to delays in the government's reporting of expenditure data. In lieu of IFMIS, Treasury and USAID are now assisting provincial governments with the use of inexpensive spreadsheet software to improve their financial management capability, according to Treasury officials.

- *National Capacity Development Program.* This USAID program is to improve public administration skills at the ministerial level and has provided training in a range of issues, including project management, budgeting, fiscal management, leadership, and information technology. As of October 2007, the program had trained more than 2,000 ministry officials from 30 different Iraqi institutions since November 2006 when the training program was first established, according to USAID officials. The program has trained 500 Iraqi government officials specifically in procurement, and 51 of the 500 completed the "Train the Trainers" course to enable them to train additional ministry officials in procurement. USAID officials also noted that the program includes imbedded teams at the Ministry of Planning and Development Cooperation that are helping ministries set up proper procurement units with procurement tracking systems.
- *Local Governance Program.* This program, operated under a USAID contract, supports Iraq's efforts to improve the management and administration of local, municipal, and provisional governments. According to USAID officials, this program includes several activities to assist with provincial budget execution. These efforts include the development of reference materials refreshed annually to reflect new guidance by the Minister of Finance and Minister of Planning and Development Cooperation; national and regional conferences that bring together provincial council members, governors, and members of their staffs to discuss provincial budget execution; and local staff in many provincial government centers assisting with provincial budget execution, as well as public finance advisors in some of the PRTs and at its Baghdad headquarters.
- *Advisors to civilian and security ministries.* These advisors assist in the development of the ministries' budget planning and contracting skills. As of mid-2007, State and USAID were providing 169 advisors and subject-matter experts to civilian ministries to implement capacity development projects and provide policy advice and technical assistance at key ministries and government entities. In addition, DOD and Multinational Security Transition Command-Iraq (MNSTC-I) provided 215 embedded U.S. and coalition military and civilian advisors to the Ministries of Interior and Defense; and a U.S. Treasury attaché advises the Ministry of Finance. Treasury reports that it has completed four multiday budget execution

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workshops in 2007 that have trained over 120 central ministry and provincial government staff members, and it plans additional training for January 2008.

The administration's September 2007 Benchmark Assessment Report concluded that the government of Iraq has steadily improved its ability to execute capital projects spending, as a result of U.S. assistance efforts. However, it is not clear what impact these efforts have had to date due to limitations with available data, outlined earlier in this report, and because much of this assistance specifically designed to improve budget execution was established too recently for U.S. agencies to fully evaluate them.

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## Conclusion

To support continued economic growth and improve the delivery of services, the government of Iraq needs to make significant investment in its infrastructure. Such investments come from the government's efficient execution of its capital budget. The administration's September 2007 Benchmark Assessment Report concluded that the government of Iraq had steadily improved its ability to execute capital projects spending as a result of U.S. technical assistance. However, the additional information provided by Treasury and State in commenting on a draft of this report did not reassure GAO that accurate and reliable data on Iraq's budget exists. State and Treasury continue to cite unofficial expenditure data to support assertions that the government of Iraq is becoming more effective in spending its capital project budget, even though the data differ significantly from the official expenditure figures generated under a new IMF-compliant chart of accounts. The discrepancies between the unofficial and official data highlight the ambiguities about the extent to which the government of Iraq is spending its resources on capital projects. Thus, we do not believe these data should be used to draw firm conclusions about whether the Iraqi government is making progress in executing its capital projects budget. The lack of consistent and timely expenditure data limits transparency over Iraq's execution of its multibillion dollar 2007 capital budget and makes it difficult to assess the impact of U.S. assistance.

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## Recommendation

To help ensure more accurate reporting of the government of Iraq's spending of its capital projects budget, we recommend that the Secretary of Treasury work with the government of Iraq and relevant U.S. agencies to enhance the Treasury department's ability to report accurate and reliable expenditure data from the ministries and provinces. This reporting

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should be based on the IMF-compliant standards rather than unofficial data sources that are of questionable accuracy and reliability.

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## Agency Comments and Our Evaluation

We provided a draft of this report to Departments of Defense, State, the Treasury, and USAID. Treasury and State provided written comments, which are reprinted in appendixes IV and V. Treasury, State, and USAID also provided technical comments and suggested wording changes that we incorporated as appropriate. DOD did not comment on the report.

Treasury and State raised several concerns in commenting on our draft report. First, Treasury stated that our analysis of Iraq's budget execution was based on incomplete and unofficial reporting, in particular, the unofficial July 15, 2007 data used to comply with a congressional reporting requirement (the September 2007 Iraq Benchmark Assessment Report). The administration highlighted this unofficial data in the September 2007 benchmark report to Congress to assert that Iraq's central government and provinces were becoming more effective at spending their capital budgets. We do not believe these data should be used to draw firm conclusions about the Iraqi government's progress in spending its capital budget. We agree that the unofficial data the administration used in the report to Congress do not portray a full and accurate picture of the situation. Accordingly, we compared these data with official Iraqi Ministry of Finance data to assess the extent to which the Iraqis had spent their capital projects budget. Since the spending gap between the administration's unofficial data and the Ministry of Finance's official data is strikingly large, we recommend that the Department of Treasury work with the Ministry of Finance to reconcile these differences.

Second, Treasury stated that our report incorrectly concluded that capital spending is only contained in the Iraqi budget item for "nonfinancial assets" (which we refer to as "investment"). State made a similar comment. Treasury and State asserted that capital spending is spread through many chapters in the new chart of accounts and that the amount is higher than the 4.4 percent cited in our report. However, State and Treasury did not provide us with evidence to demonstrate which Iraqi accounts included additional capital expenditures.

Third, Treasury questioned our comparison of 2006 and 2007 Iraqi spending as displayed in appendix II. Treasury stated that it is misleading to compare 2006 and 2007 spending levels because of changes in Iraqi spending accounts between the 2 years. We added this note of caution to appendix II. However, we also made adjustments to account for the

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differences in the budget classification systems, thereby enabling valid comparisons between 2006 and 2007 data. Table 4 outlines the key differences in the 2006 and 2007 classification systems. After updating the draft report with data through August 2007, budget execution ratios in 2007 are still lower in most cases than corresponding ratios in 2006. We believe this analysis provides additional perspective on the comparisons between 2006 and 2007 expenditures made in the administration's September 2007 Benchmark Assessment Report to Congress.

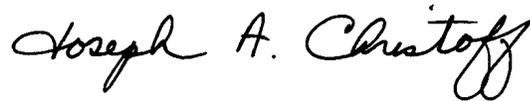
State also raised several concerns in commenting on a draft of this report. First, State commented that the draft report fails to accurately portray the "tangible progress" that the central government and provincial governments have made in budget execution. State commented that this progress represents a tangible example of Iraq's leaders working together successfully. However, we do not believe these data are sufficiently reliable to conclude that U.S. assistance efforts have already achieved success helping the Iraqi government execute its capital budget.

Second, State attributed the discrepancy between the official and unofficial data cited in our report to "a time lag in data collection" and asserted that the July 15 data are representative of the government of Iraq's performance as of the publication of the administration's September 2007 Benchmark Assessment Report. After providing our draft report to State for comment, we received updated data from Treasury that clearly refutes State's comment. These updated data show that the central ministries spent 4.4 percent of their investment budget through August 2007, raising questions about the unofficial data reported to Congress in the administration's September 2007 benchmark report.

Finally, State commented that the amount of money committed and dispersed in the provinces during 2007 is "especially impressive." However, as we noted in our report, commitments do not represent expenditures. The absence of provincial spending data in official Ministry of Finance reporting makes it difficult to determine the extent to which the Iraqi government was spending its 2007 capital projects funds. As Treasury noted in their comments, the official Ministry of Finance reporting does not show provincial spending and is working to determine the discrepancy.

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We are sending copies of this report to interested congressional committees. We will also make copies available to others on request. In addition, this report is available on GAO's Web site at <http://www.gao.gov>. If you or your staffs have any questions concerning this report, please contact me at (202) 512-8979 or [christoffj@gao.gov](mailto:christoffj@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix VI.



Joseph A. Christoff  
Director, International Affairs and Trade

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*List of Congressional Committees*

The Honorable Carl Levin  
Chairman  
The Honorable John S. McCain  
Ranking Member  
Committee on Armed Services  
United States Senate

The Honorable Joseph R. Biden, Jr.  
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Committee on Armed Services  
House of Representatives

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The Honorable Nita M. Lowey  
Chairman  
The Honorable Frank R. Wolf  
Ranking Member  
Subcommittee on State, Foreign Operations,  
and Related Programs  
Committee on Appropriations  
House of Representatives

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# Appendix I: Objectives, Scope, and Methodology

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In this report, we review the Iraq government's progress in expending its fiscal year 2007 capital projects budgets. Specifically, we (1) examine the data the U.S. embassy uses to determine the extent to which the Iraqi government has spent its 2007 capital projects budget, (2) identify factors affecting the Iraqi government's ability to spend these funds, and (3) describe U.S. government efforts to assist the Iraqi government in spending its capital projects funds. We undertook this review under the Comptroller General's authority to conduct reviews on his own initiative, and in recognition of broad congressional interest in Iraq and the critical importance of Iraqi capital expenditures in rebuilding its infrastructure.

To examine the data the U.S. Embassy in Baghdad uses to measure Iraqi government spending, we obtained expenditure data from the U.S. Department of the Treasury and the U.S. Embassy in Baghdad and interviewed knowledgeable U.S. agency officials. We reviewed three different sets of data on Iraqi government expenditures: official monthly expenditure reports from the Ministry of Finance through August 2007;<sup>1</sup> unofficial Ministry of Finance data on expenditures by central ministries, as of July 15, 2007; and U.S. Provincial Reconstruction Team (PRT) data on expenditures by Iraq's provincial governments, as of October 21, 2007. The official Ministry of Finance expenditure reports reflected a much lower rate of spending on capital projects than the unofficial Ministry of Finance and unofficial PRT data showed. We did not independently verify the precision of the data on Iraq's budget execution. However, the disparity between the different sets of data calls into question their reliability and whether they can be used to draw firm conclusions about the extent to which the Iraqi government has increased its spending on capital projects in 2007, compared with 2006. We are presenting the PRT data in appendix III for informational purposes, even though our field work raised questions about their reliability. To obtain a better understanding of Iraqi capital budget and spending data and Iraqi practices in developing expenditure data, we interviewed U.S. officials with the Departments of Defense (DOD), State (State), and the Treasury (Treasury); and the U.S. Agency for International Development (USAID) in Washington, D.C., and Baghdad. We also interviewed advisors to the Ministry of Finance, working under a contract with the United Kingdom's

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<sup>1</sup>Although Iraq's \$41 billion budget in 2007 includes \$10.1 billion for capital projects, the government's official expenditure data do not break out capital projects expenditures in 2007. Ministries report their capital projects expenditures together with expenditures for capital goods under the heading of "nonfinancial assets," which we refer to as "investment" expenditures.

Department for International Development. We also reviewed U.S. embassy reports on Iraqi budget execution, Iraqi government instructions for executing the budget, Iraq's Financial Management Law, the Special Inspector General for Iraq Reconstruction (SIGIR)'s July 2007 Quarterly and Semiannual Report to the Congress, and the administration's July and September 2007 Benchmark Assessment Reports.

To examine the factors affecting the Iraqi government's ability to spend its capital projects budget, we reviewed and analyzed reports and interviewed officials from DOD, State, Treasury, and USAID. We also interviewed advisors to the Ministry of Finance, working under a contract with the United Kingdom's Department for International Development. We interviewed these officials in Iraq over the telephone and visited Iraq in July 2007. We also reviewed Iraq's Financial Management Law and relevant reports from the World Bank, the International Monetary Fund (IMF), Ernst and Young, and SIGIR. In addition, we reviewed previous GAO reports. We reviewed information provided in these interviews and reports to identify the different factors affecting Iraq's ability to spend its capital projects budget.

To examine U.S. government efforts to assist the Iraqi government in executing its capital projects budget, we interviewed officials from DOD, State, Treasury, and USAID. We reviewed several U.S. government documents, including State's April 2007 quarterly section 1227 report to Congress on the military, diplomatic, political, and economic measures undertaken to complete the mission in Iraq;<sup>2</sup> DOD's quarterly reports to Congress, Measuring Security and Stability and Iraq, from November 2006 to September 2007; the USAID contract awarded in July 2006 to Management Systems International, Inc., Building Recovery and Reform through Democratic Governance National Capacity Development Program; a status report on USAID's implementation of the Iraqi Financial Management Information System under the Economic Governance Project II, and reports from USAID's Iraq Local Governance Program.

We conducted this performance audit from April 2007 through December 2007 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for

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<sup>2</sup>State's quarterly 1227 reports are submitted pursuant to section 1227 of the National Defense Authorization Act for Fiscal Year 2006 (P.L. 109-163).

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our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# Appendix II: Comparison of Budget Execution during the First 8 Months of 2006 and 2007

Budget execution is a relative measure comparing actual expenditures to the budget. Using the budget execution metric, the government spent 36 percent of its budget during the first 8 months of 2007, compared to 43 percent during the same period in 2006. Tables 2 and 3 provide a breakdown of budget execution for the first 8 months of 2006 and 2007, respectively. While we were not able to determine the reliability of these official Iraqi expenditure data, we are presenting this analysis because it raises additional questions about the data presented by the administration in its September 2007 assessment of Iraqi benchmarks. Whereas the unofficial Iraqi expenditure data cited by the administration suggest that the Iraqi government has improved its ability to spend capital projects funds in 2007, this analysis of official Iraqi expenditure reports suggests the opposite.

**Table 2: Government of Iraq 2006 Annual Budget and Expenditures through August 2006**

Dollars in millions

|                  | Employee compensation | Goods and services | Transfers and other | Investment | Total expenditure |
|------------------|-----------------------|--------------------|---------------------|------------|-------------------|
| Budget           | \$5,405               | \$3,634            | \$17,363            | \$7,573    | <b>\$33,975</b>   |
| Expended         | 3,531                 | 784                | 9,315               | 994        | <b>14,623</b>     |
| Not expended     | 1,874                 | 2,850              | 8,049               | 6,579      | <b>19,352</b>     |
| Percent expended | 65%                   | 22%                | 54%                 | 13%        | <b>43%</b>        |

Source: GAO analysis of Ministry of Finance data provided by U.S. Treasury.

**Table 3: Government of Iraq 2007 Annual Budget and Expenditures through August 2007**

Dollars in millions

|                  | Employee compensation | Goods and services | Transfers and other | Investment | Total expenditure |
|------------------|-----------------------|--------------------|---------------------|------------|-------------------|
| Budget           | \$11,686              | \$6,358            | \$11,623            | \$11,386   | <b>\$41,054</b>   |
| Expended         | 6,160                 | 1,709              | 6,314               | 594        | <b>14,776</b>     |
| Not expended     | 5,527                 | 4,649              | 5,309               | 10,793     | <b>26,278</b>     |
| Percent expended | 53%                   | 27%                | 54%                 | 5%         | <b>36%</b>        |

Source: GAO analysis of Ministry of Finance data provided by U.S. Treasury.

**Appendix II: Comparison of Budget Execution during the First 8 Months of 2006 and 2007**

Note: The budget for investment is the sum of the budgets for capital projects (\$10.1 billion) and capital goods (\$1.3 billion) with capital projects representing 88 percent. U.S. officials stated that, for 2007, ministries are reporting capital projects expenditures together with capital goods expenditures as part of a single budget category for investment. However, if all the \$594 million were capital projects expenditures, they would still represent less than 6 percent of the \$10.1 billion capital projects budget. Totals may not add up due to rounding.

To compare the 2006 and 2007 budgets, we combined various expenditure categories into four groups. As explained in the report, beginning in 2007, the Iraqi government adopted a new chart of accounts as recommended by the IMF, which complicates efforts to compare 2006 with 2007. Column 1 in table 4 shows the nine categories of expenditures reported in 2006 and their combination into the four groups presented in the table; column 2 shows the eight categories used in the 2007 chart of accounts.

**Table 4: Iraq Budget Classification of Expenditures Reported by Ministry of Finance, 2006 and 2007**

| 2006 Budget classifications |  | 2007 Budget classifications |                          |
|-----------------------------|--|-----------------------------|--------------------------|
| A                           | Employee compensation                  | A                           | Employee compensation    |
|                             | 1. Employee compensation               |                             | 1. Employee compensation |
| B                           | Goods and services                     | B                           | Goods and services       |
|                             | 2. Goods                               |                             | 2. Goods and services    |
|                             | 3. Services                            |                             |                          |
|                             | 4. Maintenance                         |                             |                          |
| C                           | Transfers and other                    | C                           | Transfers and other      |
|                             | 5. Transfers                           |                             | 3. Interest              |
|                             | 6. Foreign obligations                 |                             | 4. Subsidies             |
|                             | 7. Stipends and pensions               |                             | 5. Grants                |
|                             |  |                             | 6. Social benefits       |
|                             |  |                             | 7. Other expenditures    |
| D                           | Investment                             | D                           | Investment               |
|                             | 8. Operating capital                   |                             | 8. Nonfinancial assets   |
|                             | 9. Capital projects and reconstruction |                             |                          |

Source: GAO analysis of Ministry of Finance official monthly reports provided by the U.S. Treasury.

The percentage of the budget expended as of August 31 is the ratio used to measure budget execution for 2006 and 2007 in tables 1 and 2, respectively. Only in the category of goods and services did budget execution appear to increase, from 22 percent in 2006 to 27 percent in 2007. In general, the Iraqi ministries have compensated their employees. However, even in that category, budget execution decreased from 65 percent in 2006 to 53 percent in 2007.

As mentioned previously, the expenditures for capital projects are no longer reported as a separate category in official Ministry of Finance accounts. The 2007 budget provides separate categories for capital goods and capital projects. However, the reported expenditures in the category nonfinancial assets, which we refer to as investment, combine capital goods and capital projects. The capital projects budget of \$10.1 billion represents 88 percent of the combined investment category of \$11.4 billion. The budget execution ratio of this investment category was 5 percent for the first 8 months of 2007, compared with 13 percent for the first 8 months of 2006.

The expenditure performance of the Iraqi government from January through August 2007 may even be worse than the dollar expenditure figures suggest. The Ministry of Finance reports the government's budget and expenditures in its own currency Iraq dinars (ID). The U.S. Treasury converts them to dollars using a budget exchange rate of ID 1,500 per dollar in 2006 and ID 1,260 per dollar in 2007. The dollar value of expenditures from January through August 2007 is 19 percent higher due to the exchange rate conversion. Expenditures from January through August 2007 were ID 18,600 billion or about 15 percent lower than the ID 21,900 billion spent over the same period in 2006.

# Appendix III: Provincial Reconstruction Team Data on Provinces' Spending of 2006 and 2007 Capital Projects Funds

Table 5 and table 6 provides additional details on provincial capital projects budgets, by allocations, committed funds, and spent funds, for 2006 and 2007, as of October 21, 2007. These funding levels are based on data collected and reported by U.S.-led PRTs. Because the government of Iraq only reports provincial spending in the aggregate, the embassy relies on PRT data to track provincial capital projects spending. We are presenting the PRT data for informational purposes, even though our field work raised questions about their reliability.

**Table 5: Provincial Capital Projects and Reconstruction Budgets, Funds Committed and Spent, 2006 as of October 21, 2007**

Dollars in millions

| Province     | 2006 Provincial capital projects budgets |                  |                                |                |                            |
|--------------|--|------------------|--------------------------------|----------------|----------------------------|
|              | Budget allocation                        | Amount committed | Percentage of budget committed | Amount spent   | Percentage of budget spent |
| Anbar        | \$97                                     | \$78             | 80%                            | \$78           | 80%                        |
| Babil        | 111                                      | 111              | 100                            | 98             | 88                         |
| Baghdad      | 503                                      | 503              | 100                            | 427            | 85                         |
| Basrah       | 172                                      | 172              | 100                            | 115            | 67                         |
| Dhi-Qar      | 119                                      | 119              | 100                            | 119            | 100                        |
| Diyala       | 99                                       | 61               | 62                             | 0              | 0                          |
| Karbala      | 62                                       | 56               | 90                             | 56             | 90                         |
| Kurd Prov    | 131                                      | 126              | 96                             | 35             | 27                         |
| Maysan       | 66                                       | 66               | 100                            | 50             | 76                         |
| Muthana      | 46                                       | 43               | 93                             | 39             | 85                         |
| Najaf        | 79                                       | 72               | 91                             | 72             | 91                         |
| Ninawa       | 202                                      | 202              | 100                            | 202            | 100                        |
| Qadisiyah    | 74                                       | 74               | 100                            | 56             | 76                         |
| SaD          | 83                                       | 82               | 99                             | 65             | 78                         |
| Tameen       | 81                                       | 81               | 100                            | 73             | 90                         |
| Wasit        | 74                                       | 72               | 97                             | 60             | 81                         |
| <b>Total</b> | <b>\$1,999</b>                           | <b>\$1,918</b>   | <b>96%</b>                     | <b>\$1,543</b> | <b>77%</b>                 |

Source: U.S. Embassy reporting of unofficial data collected by PRTs.

**Appendix III: Provincial  
Reconstruction Team Data on  
Provinces' Spending of 2006 and  
2007 Capital Projects Funds**

**Table 6: Provincial Capital Projects and Reconstruction Budgets, Funds Committed and Spent 2007, as of October 21, 2007**

Dollars in millions

| Province     | 2007 Provincial capital projects budgets |                  |                                |              |                            |
|--------------|--|------------------|--------------------------------|--------------|----------------------------|
|              | Budget allocation                        | Amount committed | Percentage of budget committed | Amount spent | Percentage of budget spent |
| Anbar        | \$107                                    | \$52             | 49%                            | \$0          | 0%                         |
| Babil        | 112                                      | 127              | 113                            | 42           | 38                         |
| Baghdad      | 560                                      | 301              | 54                             | 70           | 13                         |
| Basrah       | 195                                      | 159              | 82                             | 12           | 6                          |
| Dhi-Qar      | 138                                      | 119              | 86                             | 2            | 1                          |
| Diyala       | 110                                      | 0                | 0                              | 0            | 0                          |
| Karbala      | 71                                       | 62               | 86                             | 17           | 24                         |
| Kurd Prov    | 314                                      | 113              | 36                             | 0            | 0                          |
| Maysan       | 76                                       | 2                | 3                              | 26           | 34                         |
| Muthana      | 52                                       | 38               | 73                             | 4            | 8                          |
| Najaf        | 88                                       | 88               | 100                            | 23           | 26                         |
| Ninawa       | 226                                      | 54               | 24                             | 17           | 8                          |
| Qadisiyah    | 64                                       | 64               | 100                            | 13           | 20                         |
| SaD          | 93                                       | 75               | 81                             | 11           | 12                         |
| Tameen       | 90                                       | 58               | 64                             | 17           | 19                         |
| Wasit        | 83                                       | 65               | 78                             | 20           | 24                         |
| <b>Total</b> | <b>\$2,381</b>                           | <b>\$1,379</b>   | <b>58%</b>                     | <b>\$275</b> | <b>12%</b>                 |

Source: U.S. Embassy reporting of unofficial data collected by PRTs.

Note: The data include \$314 million of Kurdistan region's separate 2007 capital projects allocation of \$1.56 billion. The total 2007 budget allocation for the provinces, excluding the Kurdistan region, is \$2.067 billion.

# Appendix IV: Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

December 13, 2007

Mr. Joseph A. Christoff  
Director, International Affairs and Trade  
Government Accountability Office

Dear Mr. Christoff,

Thank you for the opportunity to review and comment on the December 2007 draft of the GAO's report on budget execution in Iraq, *Iraq Reconstruction: Budget, Security, and Other Factors Limit Iraq's Ability to Execute Capital Projects Budget and Track Spending*. Treasury has been closely engaged with the Iraqi Ministry of Finance on improving budget execution, and appreciates GAO's attention to an issue that is crucial for reconstruction and growth in Iraq.

Measuring Iraq's budget execution is a difficult task, as data are often revised, and the Iraqis have just implemented a new chart of accounts that changes capital expenditure classifications. As the report notes, there are many reasons for a slow pace of budget execution in Iraq, particularly related to weak capacity and security. The U.S. government and Iraqi government have focused on addressing these problems, and we believe that incremental progress is being made. We expect that building Iraqi capacity in various ministries for a more effective financial management will take time and additional investment.

Nonetheless, we are concerned with many of the statements in this report and offer comments on each section of the report below. Treasury's attaché in Baghdad will also provide extensive informal comments on this report.

*1) Assessment of Extent to which GOI has spent its \$10.1 billion capital projects budget for 2007*

Due to data limitations and changes in Iraqi financial procedures, the pace of execution of capital projects for 2007 will not be fully known for some time. Ideally, GAO would wait until all 2007 data are available to properly analyze GOI budget execution. The GAO analysis is based on incomplete and unofficial reporting that does not portray a full and accurate picture of the situation. In particular, the GAO report focuses on preliminary data from July 15<sup>th</sup> that the administration used to comply with a requirement to report to Congress. The administration has consistently indicated that there were potential accuracy issues with the data in this report. More recent Iraqi data are helping Treasury understand some of the discrepancies in the various reporting formats from the Ministry of Finance, Ministry of Planning, Central Bank of Iraq, and PRT data.

On some specific points:

- The report incorrectly asserts that capital spending is only contained in the Iraqi budget item for "non-financial assets". But, in the new chart of accounts, capital spending is

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**Appendix IV: Comments from the Department  
of the Treasury**

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spread throughout many chapters, and is much higher than the June figure for non-financial assets.

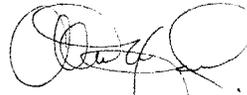
- It is misleading to make comparisons to 2006 below the aggregate spending figures because of the different charts of account. Treasury is still working with the GOI to determine just how much of the capital budget is accurately captured in MOF reports, as many discrepancies exist between different GOI reports.
- The PRT data for the provinces are just one source of data. Comparing this with spending data in the special report provides some insight into spending by the provinces. The official MOF reporting does not show provincial spending, and Treasury is again working to determine the discrepancy.

*2) Factors affecting GOI's ability to spend these funds*

- The lack of skilled workers available is not just because of De' Baathification and refugee outflow. Rather these factors compound the dearth of capacity that pervades the Iraqi civil service and society after 25 years of wars and sanctions.
- The report would benefit from fuller discussion of the overall systemic impediments and Byzantine processes that slow budget execution, in addition to the procurement, budgetary, and accounting issues highlighted in the report.

*3) USG efforts to assist the GOI in spending its capital project funds*

- Many capacity development programs require many months before they can make slight impacts on outcome-oriented objectives. We would encourage GAO to consider intermediate and qualitative indicators in its assessment of the impact of USG capacity building programs.



Ahmed M. Saeed  
Deputy Assistant Secretary, Middle East & Africa  
U.S. Department of the Treasury

# Appendix V: Comments from the Department of State



**United States Department of State**

*Assistant Secretary for Resource Management  
and Chief Financial Officer*

*Washington, D.C. 20520*

Ms. Jacquelyn Williams-Bridgers  
Managing Director  
International Affairs and Trade  
Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548-0001

Dear Ms. Williams-Bridgers:

We appreciate the opportunity to review your draft report, "IRAQ RECONSTRUCTION: Budget, Security, and Other Factors Limit Iraq's Ability to Execute Capital Projects Budget and Track Spending," GAO Job Code 320484.

The enclosed Department of State comments are provided for incorporation with this letter as an appendix to the final report.

If you have any questions concerning this response, please contact Kyle Peterson, Desk Officer, Bureau of Near Eastern Affairs, at (202) 647-9837.

Sincerely,

A handwritten signature in black ink, appearing to read "Bradford R. Higgins".

Bradford R. Higgins

cc: GAO – Steve Lord  
NEA – C. David Welch  
State/OIG – Mark Duda

Department of State Comments on GAO Draft Report

IRAQ RECONSTRUCTION: Budget, Security, and Other Factors Limit Iraq's  
Ability to Execute Capital Projects Budget and Track Spending  
(GAO-08-153, GAO Code 320484)

Thank you for the opportunity to review and comment on the December 2007 draft of GAO's report on budget execution in Iraq, *Iraq Reconstruction: Budget, Security, and Other Factors Limit Iraq's Ability to Execute Capital Projects Budget and Track Spending*. As indicated by its inclusion as a benchmark in the September 2007 Benchmark Assessment Report, the Government of Iraq's (GOI) ability to create and execute its own budget is vital to Iraq's reconstruction, fiscal stability, and the GOI's ability to meet the needs of the Iraqi people. Therefore, we welcome GAO's attention to this matter.

We are concerned that the draft report fails to accurately portray the tangible progress that the central government and provincial governments have made in budget execution. The GOI's progress on budget execution represents a tangible example of Iraq's leaders working together successfully. It also reflects increased U.S. and international assistance focused on budget execution.

We strongly disagree with GAO's characterization of the discrepancy between the June 2007 official Ministry of Finance (MoF) data and the July 15, 2007 unofficial MoF data cited in the September 2007 Benchmark Assessment Report. The July 15 unofficial data were provided to the U.S. Embassy at our request prior to the September 2007 Benchmark Assessment Report. As such, these data represented the most up-to-date information on Iraqi budget execution at that time.

The discrepancy between the June 2007 and July 15 data represents, foremost, a time lag in data collection. In the weeks between the two data sets, MoF overcame some of the lag in collection experienced previously. The 1.1 percent ministerial capital budget execution rate cited in the draft report reflects only what the MoF reported. Actual performance was higher. Given the late passage of the 2007 Federal Budget Law, the MoF was still refining its collection reporting in June. By July 15, the MoF had accelerated its data collection. Additionally, many ministries that had previously been creating budgets and committing funds began to receive and spend their capital funds at a greater rate. In summary, we stand by the statement that the July 15 data is representative of the

GOI's performance as of the publication of the September Benchmark Assessment Report, and that findings based on the outdated June data are misleading.

The MoF was also delayed in reporting budget execution data because it was implementing the International Monetary Fund (IMF)-imposed Chart of Accounts. The Chart of Accounts provides for enhanced data collection, aligns MoF accounting with international standards, and represents significant capacity development on the part of MoF officials. Given these refined and improved accounting procedures, the draft report citing 1.1 percent expenditure of Non-financial Assets does not reflect the entirety of investment spending reported. In fact, capital expenditures are recorded through all expenditure categories, including Non-financial Assets, Salaries, Goods and Services, Grants, and Other Expense.

One of the most important points about provincial budget execution in 2007, which is insufficiently highlighted in the draft GAO report, is that provincial governments have been simultaneously committing and disbursing 2006 and 2007 funds. The amount of money committed and disbursed during 2007 is thus especially impressive. Additionally, the draft report expresses concern that commitments may not be a good indicator of actual disbursements. Our data, however, suggests that for the most part they are.

There is a clear trade-off between using more timely PRT-collected data, which acts as a leading indicator, and official MoF provincial data, which is more authoritative but less timely. PRT technical advisors continually refine their data collection and reporting methods. Although some data discrepancies remain, provincial officials relay financial data to the PRTs in much the same way they report it to the MoF. We agree with GAO's recommendation that "actual spending by the provinces should be reflected in official 2007 expenditure data reported by the Ministry of Finance."<sup>1</sup> We will rely on those statistics as they become available.

Finally, we are concerned with the draft report's assessment that U.S. and international assistance efforts have not borne fruit. Based on recent data, it is clear that the intense focus on budget execution in 2007 has increased the technical ability of ministry and provincial officials to perform tasks necessary to execute their budgets. In addition to the various U.S. assistance efforts mentioned in the report, the U.S. Embassy is currently working with the MoF, the Ministry of Planning, and others to develop methods of tracking capital budget execution by

<sup>1</sup> Page 9, paragraph 2.

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project. This will help address the lack of performance measures the report identifies.<sup>2</sup>

In addition to analyzing budget execution data, PRT and Embassy officers observe and report tangible projects, levels of services, and public opinion of the Government's ability to deliver services. These 'data points' confirm that the Iraqis are improving both ministerial and provincial capital budget execution.

Based on the above considerations, we recommend that GAO reconsider the draft's report's focus to ensure a more accurate characterization of the GOI's improvements on budget execution. We would be happy to discuss the matter further or provide you with any additional assistance.

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<sup>2</sup> Page 15, paragraph 2.

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# Appendix VI: GAO Contact and Staff Acknowledgments

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## GAO Contact

Joseph Christoff, (202) 512-8979 or [christoffj@gao.gov](mailto:christoffj@gao.gov)

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## Staff Acknowledgments

In addition, Steve Lord, Acting Director; Lynn Cothorn; Howard Cott; Martin De Alteriis; Timothy Fairbanks; Victoria H. Lin; Bruce Kutnick; Mary Moutsos, and Sidney Schwartz made key contributions to this report.

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