OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

EFFORTS TO IMPLEMENT A FINANCIAL-MANAGEMENT INFORMATION SYSTEM IN IRAQ

SIGIR-08-007
JANUARY 25, 2008

SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

January 25, 2008

MEMORANDUM FOR DIRECTOR OF U.S. FOREIGN ASSISTANCE/ADMINISTRATOR,
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
U.S. AMBASSADOR TO IRAQ
ECONOMIC MINISTER/COORDINATOR FOR ECONOMIC TRANSITION IN IRAQ
MISSION DIRECTOR-IRAQ, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
DIRECTOR, IRAQ TRANSITION ASSISTANCE OFFICE

SUBJECT: Efforts to Implement a Financial-Management Information System in Iraq (SIGIR 08-007)

We are providing this audit report for your information and use. We performed this audit in accordance with our statutory responsibilities contained in Public Law 108-106, as amended, which requires the independent and objective conduct of audits relating to programs and operations funded with amounts appropriated or otherwise made available to the Iraq Relief and Reconstruction Fund. The law also requires that we provide for the independent and objective leadership and coordination of and recommendations on policies designed to promote economy, efficiency, and effectiveness in the administration of such programs and operations and to prevent and detect fraud, waste, and abuse. This review was conducted as Project 8005.

We considered comments from the U.S. Agency for International Development when preparing the final report. The comments are addressed in the report, where applicable, and a copy is included in Management Comments section of this report.

We appreciate the courtesies extended to our staff. For additional information on this report, please contact Robert Pelletier at 703-428-0739 or robert.pelletier@sigir.mil.

Stuart W. Bowen, Jr.
Inspector General

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Efforts to Implement a Financial-Management Information System in Iraq

SIGIR-08-007 **January 25, 2008**

Executive Summary

Introduction

In early summer 2003, the Coalition Provisional Authority (CPA) and the International Monetary Fund conducted assessments that identified a need for improvements in the Government of Iraq's (GoI) budget and financial control system. These assessments found that the GoI financial structure provided limited ability to monitor Iraqi ministerial budgets and expenditures, leaving the ministries vulnerable to fraud, waste, and misappropriation of funds. According to a senior advisor with the CPA, "the Iraqi Ministry of Finance had been completely looted and burned…There were no computers…Everything was paper intensive." The CPA, which then managed the budget, conceived the Iraqi Financial Management Information System (IFMIS) as a solution to manage and oversee the GoI budget.

According to the U.S. Agency for International Development (USAID), when instructed by the CPA to implement an Iraqi financial management information system, it entered into a broad-based contract with BearingPoint, Inc. for that purpose. That contract had numerous other tasks related to economic and financial reforms. IFMIS represented only a small part of the total effort and estimated cost under the contract, which was known as Economic Governance I (EG-I). In September 2004, USAID awarded to BearingPoint a follow-on contract for the continuation of the economic and financial reforms. That contract, known as Economic Governance II (EG-II), continued to fund IFMIS, which again was only a small part of the total effort and cost. Both contracts were cost-plus-fixed-fee level of effort.

In September 2006, the Joint Contracting Command Iraq/Afghanistan issued to BearingPoint two concurrent contracts for the Iraq Reconstruction Management Office—now the Iraq Transition Assistance Office (ITAO). The first had three components: two related to IFMIS and a third to fiscal policy reforms. The second contract was to integrate a procurement module into IFMIS.

In July 2007, the U.S. Embassy in Iraq ordered the suspension of the IFMIS project because the BearingPoint project leader and his security detail had been kidnapped and the GoI lacked support for the system. To provide timely information on economy and efficiency issues and respond to a request for assistance from the U.S. Embassy, the Special Inspector General for Iraq Reconstruction (SIGIR) issued an interim report concerning the IFMIS contracts.[1] In sum, SIGIR recommended that the embassy establish a working group to evaluate a number of factors impacting the way forward and that further work on a financial management system be

[1] *Interim Report on Efforts and Further Actions Needed to Implement a Financial Management Information System in Iraq* (SIGIR-08-001, October 24, 2007).

contingent on the GoI's commitment to such a system and an independent assessment of GoI needs. This report presents SIGIR's overall review results of the IFMIS project.

SIGIR's overall objective for this report was to assess the U.S. government efforts to improve GoI budgeting and financial management through IFMIS. Specifically, SIGIR looked at:

1. U.S. funding for IFMIS development and implementation.
2. The extent to which IFMIS development and implementation objectives and schedule were achieved.
3. Operational issues that impacted the success and acceptability of IFMIS.
4. USAID's actions with regard to the recommendations in SIGIR's interim report.

Results in Brief

IFMIS had achieved limited functionalities before it was shut down in June 2007. Its costs at that time were estimated at $26 million. Lack of support for the system within the GoI and security issues were the key contributing factors to the shut-down. In November 2007, USAID began initiatives to ensure GoI support for the system in the future. In mid-January 2008, the Iraqi Minister of Finance and Acting Mission Director of USAID signed a Memorandum of Understanding to restart the system. These initiatives are in line with SIGIR's prior recommendations to secure the GoI's commitment to a financial management information system, and that USAID undertake an independent, third-party assessment of GoI management-system requirements and capabilities.

Although deteriorating security conditions and competing demands no doubt adversely impacted IFMIS development, there was also a lack of clear direction based on user requirements. Neither the USAID EG-I and EG-II contracts nor BearingPoint's work plans provided that direction. Information was not available to clearly assess progress on the system in relation to available benchmarks, making it difficult for USAID to assess BearingPoint's performance.

Cost is an important factor in managing any system's development, and the USAID contracts did not require the identification of IFMIS costs. SIGIR considers that a weakness in the contract requirements. SIGIR also believes that the use of the cost-plus-fixed-fee level of effort contracts was not the best choice for a system development and implementation effort because it placed greater cost risk on the U.S. government.

SIGIR recognizes that Iraq was and still is a complex and difficult environment in which to operate and that policy considerations drove many of the early decisions on how to help improve the GoI's financial management information. Because IFMIS development and implementation had ceased and SIGIR previously provided recommendations for improving the system, SIGIR makes no further recommendations. However, SIGIR believes that valuable lessons—with broader applicability—can be gleaned from the course followed by the IFMIS development project.

U.S. Funding for IFMIS Cannot Be Fully Calculated

Although we could not fully calculate from agency official accounting records the total U.S. funds expended for IFMIS, available information indicates it is about $26 million.[2] The two ITAO contracts identify IFMIS-related costs, but the USAID contracts do not differentiate IFMIS related costs from others. According to the Corps of Engineers, which is responsible for maintaining the financial data for ITAO contracts, ITAO had spent $4,060,723 for IFMIS-related modules as of October 2007. When asked for its IFMIS cost estimates, USAID provided BearingPoint's estimates. According to BearingPoint, which is responsible for reporting its costs to USAID, $22,093,386 million of the EG-I and EG-II contract costs relate to IFMIS. Based on the ITAO cost data and the BearingPoint estimate, IFMIS-related costs therefore appear to be about $26 million.

The cost-plus-fixed-fee level of effort type contracts USAID utilized for the IFMIS project are more suitable for research or a preliminary exploration study than for a system development and implementation effort. According to USAID, it made the right choice in choosing these type contracts because they provided maximum flexibility needed for the Iraqi environment.

Reconstruction Policy Decisions and Guidance, Rather Than User Needs, Drove IFMIS Development

According to International Monetary Fund and World Bank studies, a sound information-technology project design is predicated on the identification of user requirements. However, the GoI requirements were never identified. According to USAID, that resulted from a policy decision made initially by the CPA and maintained by other U.S. government organizations. Without Iraqi user requirements to guide the system development, IFMIS development appears to have been driven by U.S. reconstruction policy decisions, CPA guidance, and BearingPoint work plans.

The USAID EG-I and EG-II cost-plus-fixed-fee level of effort contracts do not provide clear objectives, tasks, and timeframes for IFMIS development. According to USAID, the BearingPoint work plans it approved rather than the EG-I and EG-II contracts delineated requirements and deliverables. SIGIR found the work plans lacking content and clear direction, specific deliverables, and set timelines. Given their absence, it would have been difficult for USAID to measure BearingPoint's progress on the system. SIGIR also found that USAID personnel in Baghdad lacked specific knowledge about deliverables and their status. All our questions in this regard were directed to BearingPoint.

Despite these issues and a difficult security environment, BearingPoint had developed and implemented a system that captured most of the GoI budget, allowed vouchers to be processed, payments to be made, and reports to be generated. However, SIGIR identified a number of issues adversely impacting IFMIS operations.

[2] We reported a cost estimate of $38 million in our October 2007 interim report on IFMIS. On the basis of more-current cost data, we have revised that estimate to $26 million.

Operational Issues Impacting IFMIS

A number of issues remain to be resolved before IFMIS can be relied upon to generate reports that address Iraqi needs. SIGIR's review identified IFMIS operational issues that affected the system's acceptance by GoI ministries. For example, SIGIR found that ministries had problems with spending units,[3] the reports produced by the system, and data reliability. SIGIR also found that as alternatives to IFMIS, the Ministry of Finance continued to use legacy systems, while other ministries, such as Defense and Interior, had developed their own financial management systems.

At the time SIGIR completed its review in December 2007, USAID was preparing to undertake an independent assessment of GoI needs, and had initiated discussions with the Ministry of Finance to secure GoI commitment to IFMIS. Those actions were consistent with SIGIR's prior recommendations.

Lessons Learned

Because IFMIS development and implementation has ceased and SIGIR previously provided recommendations on the system, SIGIR makes no further recommendations. However, SIGIR believes that valuable lessons—with broader applicability—can be gleaned from the course followed by the IFMIS development project:

- User commitment and requirements identification are critical to the success of any management-information system development and implementation effort and should be prerequisites for any system development.

- Clear objectives and a schedule to achieve them are needed to effectively manage the work of contractors involved in developing systems and should be clearly articulated in contract documents.

- Management needs accurate and complete expenditure information to effectively manage project or program costs, and contracts should be written to require that information.

Management Comments and Audit Response

USAID strongly disagreed with our positions and information on the status and cost of the system and the type of contract used. SIGIR believes its positions are sound and the information in the report accurate. SIGIR addresses these differences in this report, where applicable. Further, SIGIR added recent information pertaining to the GoI's commitment to IFMIS. A copy of USAID's detailed comments is included in the Management Comments section of this report.

[3] Spending units are workstations used to transmit payment and revenue transactions from the ministries/agencies to the IFMIS central database and receive trial balances in return.

Introduction

In early summer 2003, the Coalition Provisional Authority (CPA) and the International Monetary Fund (IMF) conducted assessments that identified a need for improvements in the Government of Iraq's (GoI) budget and financial control system. These assessments found that the GoI financial structure provided limited ability to monitor Iraqi ministerial budgets and expenditures, leaving the ministries vulnerable to fraud, waste, and misappropriation of funds. According to a senior advisor with the CPA, "the Iraqi Ministry of Finance had been completely looted and burned …There were no computers…Everything was paper intensive." As a result, the Iraqi Financial Management Information System (IFMIS) was conceived by the CPA as a needed solution to manage and oversee the GoI budget, which was then managed by the CPA. According to the U.S. Agency for International Development (USAID), when instructed by the CPA to implement an Iraqi financial management information system, it contracted with BearingPoint, Inc. to develop and implement that system.

In July 2007, the U.S. Embassy in Iraq ordered the suspension of the IFMIS project because the BearingPoint project leader and his security detail had been kidnapped and the GOI lacked support for the system. To provide timely information on economy and efficiency issues and respond to a request for assistance from the U.S. Embassy in Iraq, we provided, in October 2007, recommendations and interim results concerning the IFMIS contracts.[4] In sum, we recommended that the U.S. Embassy establish a working group to evaluate a number of factors impacting the way forward and that further work on a financial-management system be contingent on the GoI's commitment to such a system and an independent assessment of GoI needs. This report presents our overall review results on the IFMIS project.

IFMIS-Related Contracts

IFMIS development and implementation efforts were primarily performed under contracts between USAID and BearingPoint. In addition, the Iraq Reconstruction Management Office—now the Iraq Transition Assistance Office (ITAO)—had two contracts with BearingPoint to incorporate IFMIS modules.

In accordance with CPA directions to develop an Iraqi financial-management information system, USAID contracted for that system in 2003 under a broad-based contract with BearingPoint. IFMIS represented only a small part of the total effort and estimated cost under the contract known as Economic Governance I (EG-I).[5] The contract included numerous other tasks related to economic and financial reforms for Iraq. The initial performance period of the contract was from July 18, 2003, to July 17, 2004. It also provided for two option years. They were not exercised, but the performance period was extended to September 30, 2004. The total estimated cost of the contract, for the initial period and extension, was $79,583,885.

[4] *Interim Report on Efforts and Further Actions Needed to Implement a Financial Management Information System in Iraq* (SIGIR-08-001, October 24, 2007).
[5] Contract number RAN-C-00-03-00043-00.

In September 2004, USAID awarded a follow-on contract to BearingPoint for the continuation of the economic and financial reforms.[6] Known as Economic Governance II (EG-II), it continued to fund IFMIS. As with the EG-I contract, IFMIS represented only a small part of the total effort and estimated cost of EG-II. The contract specified an initial performance period from September 3, 2004, to September 2, 2007, had a total estimated cost of $184,637,237, and provided for two option years. The options, exercised in June 2007, extended the performance period to September 2, 2009, and increased the contract's total estimated cost to $224,999,967.

In September 2006, the Joint Contracting Command-Iraq/Afghanistan issued two concurrent contracts for the Iraq Reconstruction Management Office—now ITAO—to BearingPoint. The first contract had three components:[7] two related to IFMIS and a third to fiscal policy reforms. The contract performance period was October 1, 2006, to September 30, 2007, and the total estimated cost was $4,525,718. The second contract was to integrate a procurement module into IFMIS;[8] the contract performance period was October 1, 2006, to September 30, 2007, and the total estimated cost $4,196,884.

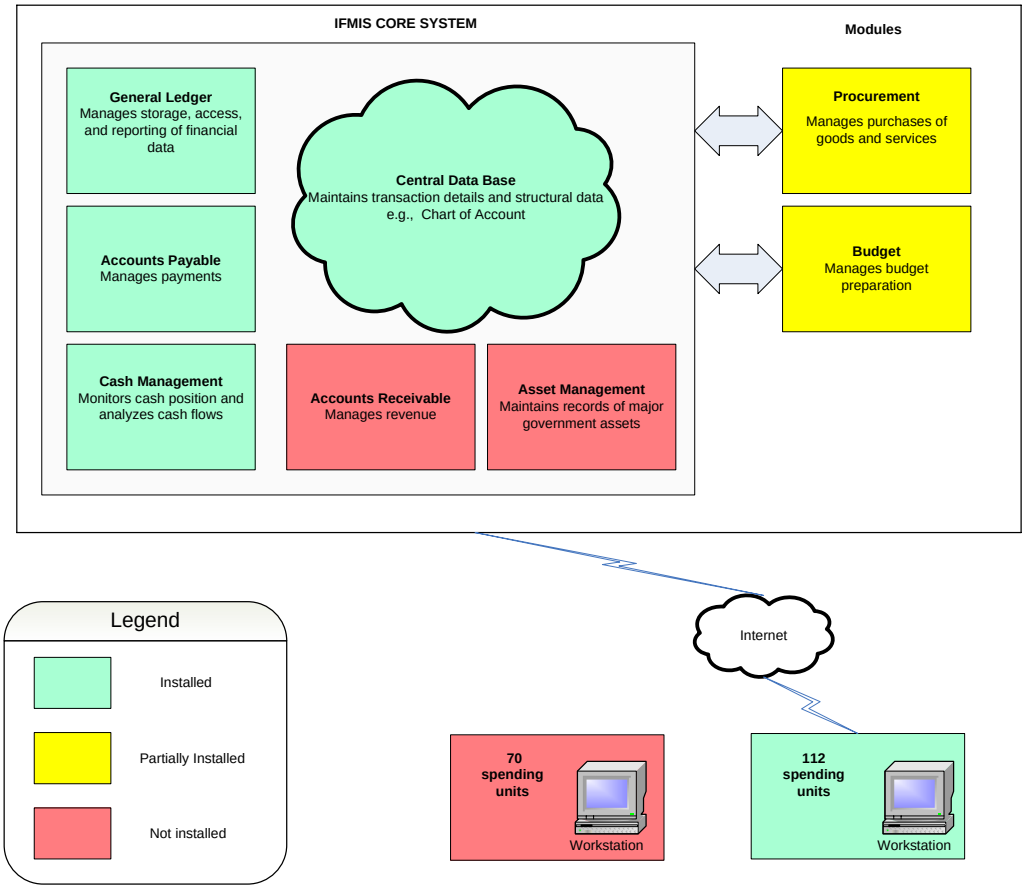
IFMIS Operations Had Been Suspended

Following the kidnapping of the BearingPoint project leader and his security detail in May 2007, according to USAID, the Ministry of Finance did not encourage GoI staff to return to work at the IFMIS data center, and the ministry effectively shut down IFMIS operations. In late June 2007, therefore, USAID suspended IFMIS implementation activities under the EG-II contract. Activities under the ITAO contracts were subsequently cancelled. IFMIS was dormant at the time we completed our review in December 2007.

IFMIS had its core system at the Ministry of Finance and spending units in the ministries and agencies. At the core are a central database and general ledger, accounts payable, and cash management functions. At the time the system was shut down, work had been underway to incorporate budget and procurement modules. In addition, there were plans to incorporate accounts-receivables and assets-management modules, as well as to install 182 spending units. (Only 112 were installed as of October 2007.) The spending units are used to transmit payment and revenue transactions from the ministries/agencies to the Ministry of Finance for recording in the IFMIS central database. In return, that ministry provided one trial balance financial report for each ministry/agency. The spending units are linked to the Ministry of Finance database via the Internet. The following figure depicts the IFMIS components.

[6] Contract number 267-C-00-04-00405-00.
[7] Contract number W916GXQ-06-C-0009.
[8] Contract number W916GXQ-06-C-0010.

Figure 1: IFMIS Components



Note:

Spending units are designed to transmit payment and revenue transactions from the ministries/agencies to the IFMIS central database and receive trial balances in return.

Source: Developed by SIGIR from USAID and BearingPoint documents.

Objectives

Our overall objective in this review was to assess the U.S. government's efforts to improve GoI budgeting and financial management through IFMIS. Specifically, we assessed:

1. U.S. funding for IFMIS development and implementation.
2. The extent to which IFMIS development and implementation objectives and schedule were achieved.
3. Operational issues that impacted the success and acceptability of IFMIS.
4. USAID's actions with regard to the recommendations in our interim report.

U.S. Funding for IFMIS Cannot Be Fully Calculated

Although we could not fully calculate from agency official accounting records the total U.S. funds expended for IFMIS, available information indicates it is about $26 million.[9] The two ITAO contracts identify IFMIS-related costs, but the USAID contracts do not differentiate IFMIS related costs from others. According to the Corps of Engineers, which is responsible for maintaining the financial data for ITAO contracts, ITAO had spent $4,060,723 for IFMIS-related modules as of October 2007. When asked for its IFMIS cost estimates, USAID provided BearingPoint's estimates. According to BearingPoint, which is responsible for reporting its costs to USAID, $22,093,386 million of the EG-I and EG-II contract costs relate to IFMIS. Based on the ITAO cost data and the BearingPoint estimate, IFMIS-related costs therefore appear to be about $26 million.

The cost-plus-fixed-fee level of effort type contracts USAID utilized for the IFMIS project are more suitable to research or a preliminary exploration study than for a system development and implementation effort. According to USAID, it made the right choice in choosing these type contracts because they provided maximum flexibility needed for the Iraqi environment.

ITAO Expenditures Related to IFMIS Can Be Calculated

ITAO had two contracts that supported IFMIS. The first contained three components: the integration of a budget-preparation system module into IFMIS, intergovernmental fiscal policy reforms, and extension of IFMIS to the provinces. The second contract involved one task; to integrate a procurement module into IFMIS. The following table shows the funds allocated to and expended for the two contracts:

Table 1: Funds Allocated and Expended for ITAO Contracts, as of October 2007

CONTRACT/COMPONENT	FUNDS ALLOCATED	FUNDS EXPENDED
Contract W91GXQ-06-C-0009		
IFMIS budget module	$2,359,174	$1,996,805
Fiscal reforms	1,279,200	0
Extension of IFMIS	890,200	0
Subtotals	**4,528,574**	**1,996,805**
Contract W91GXQ-06-C-0010	4,196,884	2,063,918
Totals	**$8,725,458**	**$4,060,723**

Source: Corps of Engineers

[9] We reported a cost estimate of $38 million in our October 2007 interim report on IFMIS. On the basis of more-current cost data, we have revised that estimate to $26 million.

USAID Contracts Did Not Require IFMIS Costs To Be Identified

According to the USAID EG-I contract with BearingPoint, the purpose of the project was to "provide economic rehabilitation and reform for Iraq to stimulate the country's international trade engagement, employment and broad-based prosperity." Fulfillment of the contract would:

> "facilitate a rapid and responsible economic integration of Iraq with its regional and international partners in order to create sustainable job generation, adopt international standards of production, harmonize economic policy, reinforce traditional trade linkages and develop new trade partnerships, and will develop and implement a roadmap for managing the economic and technical work to assure the food policy safety net is available for those who may be unable to function on the private market after cessation of the UN food program."

The EG-I project had five components:

1. Economic Governance: Policy, Regulatory, and Legal Climate for Growth
2. Microeconomic Foundations for Growth: Competitiveness Initiative
3. Privatization: Assessment and Support
4. Credit Activities: Lending to Micro Enterprises, Small- and Medium-Size Businesses
5. Food for Oil: Develop and implement a road map to assure an adequate social safety net after phase-out of the United Nations Food for Oil program.

Each of the components involved multiple tasks and benchmarks. All IFMIS-related tasks are included in the Economic Governance component. Because EG-I was a cost-plus-fixed-fee level of effort contract, BearingPoint was required to report its costs to USAID. However, the contract required that BearingPoint report all of them as a single contract-line item and not by components, tasks, or other work-breakdown structure. Therefore, all costs for work performed under the five components listed above were reported as one line item.

According to the EG-II contract, the work would "establish a legal and institutional framework that enables Iraqis to pursue their economic and societal objectives—individually and collectively." The contract also contained multiple components and tasks, including those specifically related to IFMIS development and implementation. The work was organized under the following six components:

1. Tax, Fiscal, and Customs Reform
2. Monetary Policy Through Building the Capacity of the Central Bank of Iraq
3. Development of the Banking Sector
4. Commercial Law and Institutional Reform
5. Capacity Building of the Iraqi Electricity and Communications Industries
6. Social Services

All IFMIS-related tasks are included in the first component—Tax, Fiscal, and Customs Reform. For example, one of those tasks was to oversee the completion of the roll-out of IFMIS within the Ministry of Finance, 18 Governorates, and 28 related Ministries.

The EG-II contract is also a cost-plus-fixed-fee level of effort contract. The cost-reporting requirements for EG-II were the same as for EG-I; all costs for the six components were to be reported as a single contract-line item and not by a more finite work-breakdown structure, such as IFMIS. Consequently, the official accounting records do not provide a basis for calculating IFMIS costs.

We asked USAID for its IFMIS cost estimate and were provided with BearingPoint estimates as of May 2007. They specified costs of $2,361,679 million under EG-I and $19,731,707 under EG-II, for a total of $22,093,386 million related to IFMIS. The largest cost item was for security, which totaled $11,641,281, or 53% of total costs. BearingPoint also estimated a total of 16,256 person-days had been used for IFMIS under the EG-I and EG-II contracts, as follows:

- 2,251 person-days for the period July 2003 to September 2004 for EG-I
- 14,005 person-days for the period September 2004 through September 2007 for EG-II

USAID's Contract Type Was Not Well Suited to a System Development Project

Both USAID EG-I and EG-II contracts were cost-plus-fixed-fee level of effort contracts, a type that provides less cost risk to the contractor. Under it, according to the Federal Acquisition Regulation, Subpart 15.404-4, the contractor assumes the least cost risk in that the contractor is reimbursed costs determined to be allocable and allowable, plus the fixed fee. According to the Federal Acquisition Regulation, Subpart 16.306, the cost-plus-fixed-fee contract also gives the contractor only a minimum incentive to control costs and is more suitable for "the performance of research or preliminary exploration or study, and [where] the level of effort required is unknown." IFMIS, in our view, was more than a research or preliminary study effort; it was a system development and implementation effort.

According to USAID, it made the right choice in choosing cost-plus-fixed-fee level of effort contracts for EG-I and EG-II because these contracts provided the maximum flexibility needed for the Iraqi environment. USAID said it required a type of contract that would be able to adapt and change to evolving needs in a dynamic environment. Both EG-I and II were written well before they would be implemented. (Work on developing the EG-I contract began prior to the fall of Baghdad.) According to USAID, both contracts allowed for USAID to support the CPA and later the U.S. Embassy by providing the ability to meet new needs and adjust to changes in priorities.

Reconstruction Policy Decisions and Guidance, Rather Than User Needs, Drove IFMIS Development

According to IMF and World Bank studies, a sound information-technology project design is predicated on the identification of user requirements. However, the GoI requirements were never identified. According to USAID, that resulted from a policy decision made initially by the CPA and maintained by other U.S. government organizations. Without Iraqi user requirements to guide the system development, IFMIS development appears to have been driven by U.S. reconstruction policy decisions, CPA guidance, and BearingPoint work plans.

The USAID EG-I and EG-II cost-plus-fixed-fee level of effort contracts did not provide clear objectives, tasks, and time-frames for IFMIS development. According to USAID, the BearingPoint work plans it approved, rather than the EG contracts, delineated requirements and deliverables. We found the work plans also lacking content and clear direction, specific deliverables, and set timelines. Given their absence, it would be difficult for USAID to measure BearingPoint's progress on the system. We also found that USAID personnel in Baghdad lacked specific knowledge about contract deliverables and their status. All of our questions in this regard were directed to BearingPoint.

Despite these issues and a difficult security environment, BearingPoint had developed and implemented a system that captured most of the GoI budget, allowed vouchers to be processed, payments to be made, and reports to be generated. However, we identified a number of issues adversely impacting IFMIS operations. For example, significant efforts would be required before IFMIS could be relied upon to generate reports that address Iraqi needs. Also, we found that other ministries, such as Defense and Interior, had developed their own financial management systems that could not transfer data to IFMIS. As a result, ministry personnel had to manually input data through spending units at the ministries. According to USAID officials, the data transfer problem can be fixed through a long term process of system improvements and those improvements would be a GoI responsibility.

User Needs Were Not Considered

According to IMF and World Bank studies,[10] financial-management information system projects in developing countries achieve limited success because they are not designed to meet either users' needs or functional requirements. The functional-requirements documents should serve as the blueprint for the system development and, if they are wrong, it is difficult to rectify the situation later. In 2003, a team from the IMF advised the CPA and USAID against implementing an automated financial-management system before a formal requirements analysis was conducted. The CPA and USAID nonetheless proceeded with IFMIS without undertaking the necessary analysis. That, according to USAID, was done at the initial direction of the CPA and the subsequent direction of the Iraq Reconstruction Management Office and the Office of the Treasury attaché.

[10] The IMF and World Bank provide technical assistance to help countries effectively mange their economic policies and financial affairs.

BearingPoint prepared a conceptual and functional design in 2005. However, that document was reviewed by IMF and World Bank representatives, as well as others, and the consensus was that it lacked three necessary components: adequate information about the existing Iraqi business processes, the manner in which IFMIS would support these processes, and the nature and extent of any changes to the processes that may be required for effective and efficient operation of the system.

Broad Guidance Appears to Have Driven the IFMIS Development Approach

According to USAID, the end goal for IFMIS remained "surprisingly consistent" throughout the design and implementation effort. That goal was an automated, nation-wide financial-management information system. USAID stated that, in trying to achieve such a system, it operated in "an environment with a wide array of U.S. and international donors simultaneously conducting reform efforts and in which USAID regularly adapted system requirements to support external policy decisions." USAID also stated that a CPA task order (Task 8—Financial Management Information System)[11] and USAID-approved BearingPoint work plans, rather than the EG-I and EG-II contracts, delineated requirements and deliverables. This ensured that USAID activities would be highly adaptive and responsive to changing needs on the ground. Moreover, USAID stated the EG-I contract provided for that needed flexibility, as follows:

> "The selection of tasks and indicative benchmarks to be achieved in the first year of the contract is subject to the policy approval process of the US government regarding this activity, a process to be established by USAID to assure that economic governance activities carried out by the Contractor support the policy objectives of the United States government."

USAID stated that the initial scope of work for IFMIS was not articulated in the EG-I contract but in CPA Task 8, which was developed by USAID and approved by the CPA in August 2003. The scope of work shown below describes an overall goal for the system and two phases of development.

- Procure and implement a comprehensive financial management-information system to enable the Ministry of Finance to effectively execute the national budget. The functionalities of the system being proposed will satisfy the IMF recommendations for rebuilding public-expenditure management in Iraq.
- The immediate objective is to implement the core foundation components of the system, which includes expenditures and cash management, in the Ministry of Finance, line agencies, and regional government entities.
- Once that is accomplished, the other applications necessary for managing assets and public revenue receipts, regulating public procurement, managing government debt, and financial reporting will be developed and implemented to complete the comprehensive system.

[11] CPA Task 8 was one of 12 CPA-approved tasks that defined the scope of work for the EG-I contract.

CPA Task 8 also identified tasks and deliverables for IFMIS. However, the tasks are very broad and not relatable to the two development phases articulated in the scope of work above. For example, Task 8 required the following:

- Identify, procure, and install all hardware, software and/or communication infrastructure necessary for IFMIS to become fully operational. Ensure that all system documentation and long-term, sustainable maintenance contracts are in place.
- Install IFMIS, and make it operational, by January 1, 2004.

The initial BearingPoint work plan, dated October 27, 2003, provided no additional specifics in terms of tasks or deliverables. The document projects that the IFMIS project would be planned and managed, and the core accounting system for expenditures and basic cash management at the Ministry of Finance implemented, during the period September 15, 2003 through April 3, 2004.

According to USAID, the second BearingPoint work plan, dated January 28, 2004, identified three phases of implementation:

- Phase I (January 1, 2004—March 7, 2004) entails initial design work and installation of 130 computers in the Ministry of Finance.
- Phase II (March 8, 2004—mid-July 2004) includes the rollout of the system to all of that ministry's offices in Baghdad. More than with Phase I, Phase II relied on a number of externalities, including completion of the communications network in Baghdad and computer centers in the Ministry of Finance and other ministries, and delivery of all necessary equipment as well as continued support from the Ministry of Finance and a permissive security environment.
- Phase III (mid-July 2004—end of 2004) is the national rollout of the IFMIS throughout all Treasury Governorates in Iraq.

The work in Phases I and II was to be accomplished during the performance period of the EG-I contract, which was in force through July 17, 2004. However, as USAID stated, that work did not correspond to the tasks described in the EG-I contract but to the BearingPoint work plans developed later. The contract specified that, during the period March 2004—July 2004, "A fully automated budget, reporting, and tracking system (including the installation and application of appropriate budget planning and execution software) is implemented in at least 50% of line agencies and one-third of all provinces and localities (municipalities and districts)."

In July 2004, the EG-I contract was extended for 2 ½ months to continue such tasks as implementing and testing IFMIS in Ministry of Finance treasury operations and beginning to implement the system in other key ministries. USAID stated that the extension maintained several technical activities, including support to IFMIS.

Although USAID said the EG-I contract requirements were met satisfactorily, USAID officials and BearingPoint advisors nonetheless identified a number of organizational, leadership, and security-related challenges. Organizationally, the Ministry of Finance lacked the technical, professional, and managerial capacity, while staff members worked with a low level of computer literacy—problems that required significant training and technical assistance to overcome.

Progress toward goals significantly depended on ministry leadership, both in implementing supporting policy and in providing such basic tools as reliable electricity and as Internet connections. In addition, the EG-I project operated at a time of deteriorating security, which increasingly limited access to the Ministry of Finance. Moreover, according to USAID, IFMIS components of the EG-I contract faced competing priorities. For example, the CPA requested more money for capital expenditures, drawing resources away from other components.

The EG-II contract, awarded in September 2004, was for overseeing completion of Phase III—the national rollout of IFMIS in all Treasury Governorates in Iraq. As such, the contract required BearingPoint to perform such tasks as overseeing the entire rollout within the Ministry of Finance, the 18 Governorates, and 28 related ministries; and assuring a completed system installation within the first year. According to USAID, it approved on October 25, 2004, the EG-II initial work plan, covering the period between November 2004 and the following January. That work included completing the implementation of IFMIS within the ministry, the Governorates, and the related ministries. Implementation included all hardware, software, and networking requirements, all required training, and development of financial reports.

According to USAID, Phase III had two sub-phases. The first had as its goal full activation of 56 spending units. USAID stated this was completed by August 15, 2005, and covered 85% of the Iraqi budget. The second sub phase, which was underway by September 1, 2005, had two components:

- Installation of 65 spending units—40 in Baghdad and 25 outside of Baghdad. (The total was increased to 81 by April 2006.) These sites represented 10% of the Iraqi budget.
- Installation of 61 additional spending units. According to USAID, the Ministry of Finance, as a sign of commitment, had agreed to roll IFMIS out to these final 61 spending units. (The number was later reduced to 45 by April 2006.)

According to USAID, contract requirements were met. "Key components" were completed prior to late May of this year, and IFMIS was fully functional. A total of 112 spending units were connected to the system and capable of entering data. Deteriorating security conditions slowed connection of the less-central, relatively small budget sites. They generally lie outside of Baghdad, and have limited access to electricity and the Internet.

We found it exceedingly difficult to understand the various deliverables and their time frames in the USAID contracts and approved work plans. Our attempts to understand specific objectives and time frames by means of discussions with USAID's Baghdad staff proved equally difficult. Those staff members, we found, lacked sufficient knowledge about contract deliverables and their status. USAID personnel in Baghdad referred all of our questions about the IFMIS system's status to BearingPoint.

As discussed in SIGIR's October 2007 interim report, and the next section, a number of issues adversely impacted IFMIS operations. For example, we found that other ministries, such as Defense and Interior, had developed financial management systems for their own needs but unable to transfer data to IFMIS. As a result, these ministry personnel had to manually input data through their own spending units. According to USAID officials, the data transfer problem

can be fixed through a long term process of system improvements and those improvements would be a GoI responsibility.

Operational Issues Impacting IFMIS

A number of issues remained to be resolved before IFMIS could be relied upon to generate reports that address Iraqi needs. Our review identified IFMIS operational issues that impacted the system's acceptance by GoI ministries. For example, we found that ministries had problems with spending units, the reports produced by the system, and data reliability. We also found that as alternatives to IFMIS, the Ministry of Finance continued to use legacy systems, and other ministries, such as Defense and Interior, had developed their own financial management systems.

At the time we completed this audit USAID was preparing to undertake an independent assessment of GoI needs, and had initiated discussions with the Ministry of Finance to secure GoI commitment to IFMIS. These planned actions are consistent with our prior recommendations.

IFMIS Operational Issues

During our review, we learned of a number of problems that impacted the use of spending units. According to senior U.S. advisors to Iraqi ministries and Iraqi officials, the ministries had difficulty using their spending units because:

- Electricity, which was required for unit operations and Internet connections, had limited and uncertain availability.

- Internet transmission via satellite—required to transmit ministry data to the Ministry of Finance—was periodically terminated because the GoI did not pay transmission fees.

- Trained personnel to input financial data were in short supply. Many ministry personnel, who were initially trained by BearingPoint to use spending units, had left the country due to the difficult working environment and persistent security risks. In March 2007, BearingPoint turned over to the Ministry of Finance responsibility for training individuals on the use of spending units; however, according to a senior advisor to the ministry, the latter did not have the capability to deliver such training.

- Access to IFMIS was restricted to one or two people in other ministries, because the Ministry of Finance was slow to approve access rights to individuals there. This proved to be a problem because many people who were given access rights to the system had left the ministries and sometimes the country.

- Spending units were not user friendly. Data had to be entered one record at a time, and some ministries were obligated to enter thousands of records. This process was burdensome and subject to data errors.

The issues cited above contributed to data-accuracy problems and incomplete financial data, which in turn adversely impacted the usefulness of IFMIS. Another factor limiting the system's utility was the ministries' inability to obtain the types of financial reports they needed to manage. According to U.S. advisors and Iraqi officials, the reports received from the Ministry of Finance

provided only aggregate information, and not the detailed breakdowns required to oversee a ministry's operations. The ministries requested more detailed reports, but the Ministry of Finance did not provided them. According to USAID officials, they wanted to provide more detailed data and requested authority to do so but were denied that authority.

As alternatives to IFMIS, some agencies implemented their own financial management systems or continued to use legacy systems or manual processes. We learned that the Ministries of Defense and Interior implemented their own Oracle-based systems to manage the Iraqi military and civilian police workforce located throughout the country. Both the Oracle-based systems and the legacy systems were incompatible with IFMIS and could not transfer financial data from one system to the other. As a result, ministry personnel had to enter data into IFMIS as well as into their own ministry's systems, which contributed to frustrations, additional work, and data entry errors. According to USAID officials, the CPA specifically directed USAID and BearingPoint not to incorporate the Ministries of Defense and Interior into IFMIS because these ministries provide funding for defense related functions; their financial management systems were to be implemented as an initiative of the U.S. Department of Defense.

We were told by U.S. Embassy officials that the Ministry of Finance continued to operate and use legacy systems in parallel with IFMIS and reverted to them when IFMIS was shut down. According to USAID and BearingPoint personnel, it is not unusual to operate legacy systems in parallel with new systems until the new systems are fully tested and proven to be operationally ready.

Status of Actions on Recommendations in SIGIR's Interim Report

USAID is taking or planning to take actions that are consistent with the recommendations in our interim report. In our October 2007 interim report, we recommended that (1) the U.S. Embassy establish a working group and draw on outside experts as necessary to evaluate several factors, including GoI financial-management system requirements and capabilities as well as how best to meet those requirements; (2) the Department of State make conditional future work and funding for such a system on securing GoI's commitment to it and on the results of a GoI-sponsored independent assessment of financial management needs; and (3) the Department of State help the GoI determine interim solutions that will improve financial data management, especially in the provinces, until a new operational system is developed.

With regard to evaluating GoI management-system requirements and capabilities, USAID is preparing to undertake an independent, third-party assessment. And according to USAID, with regard to securing the GoI's commitment to IFMIS, USAID and U.S. Embassy officials met on November 10 with the Special Advisor to the Minister of Finance and three Directors General to discuss the future of IFMIS. Over the course of the conversation, the Special Advisor noted his commitment to the continuing development and implementation of IFMIS. On November 20, the USAID Mission Director sent a letter to the Special Advisor proposing a series of joint steps with the Ministry of Finance to ensure GoI support for and leadership in reaching that goal. The GoI has requested follow-up meetings. In addition, at the request of the Iraqi Ministry of Finance, a Memorandum of Understanding was signed in mid-January 2008 by the Minister of Finance and Acting Mission Director of USAID to restart the system. According to USAID, under the Memorandum of Understanding, the Minister of Finance makes a substantial

commitment of effort and resources to the restart of the system with USAID assistance. A copy of the Memorandum is included with the USAID Management Comments.

Conclusions and Lessons Learned

Conclusions

IFMIS had achieved limited functionalities before it was shut down in June 2007. Its costs at that time were estimated at $26 million. Lack of support for the system within the GoI and security concerns were the key contributing factors to the shut-down. In November 2007, USAID began initiatives to ensure GoI support for the system in the future. In mid-January 2008, the Iraqi Minister of Finance and Acting Mission Director at USAID signed a Memorandum of Understanding to restart the system. The initiatives now underway are in line with our prior recommendations about securing GoI's commitment and about ensuring USAID's effort to undertake an independent, third-party assessment of GoI management-system requirements and capabilities.

Although deteriorating security conditions and competing demands no doubt adversely impacted IFMIS development, there was also a lack of clear direction based on user requirements. The USAID contracts and BearingPoint work plans did not provide that direction. Information was not available to clearly assess progress on the system in relation to available benchmarks, making it difficult for USAID to asses BearingPoint's performance.

Cost is an important factor in managing any system's development, and the USAID contracts did not provide for the identification of IFMIS costs. We believe this was a weakness in the contract requirements. We also believe the use of the cost-plus-fixed-fee level of effort contracts was not the best contract choice for a system development and implementation effort because it placed greater cost risk on the U.S. government.

We recognize that Iraq was and still is a complex and difficult environment in which to operate and that policy factors drove many of the early decisions on how to improve the GoI's financial management information. However, in retrospect, we believe that valuable lessons—with broader applicability—can be gleaned from the course followed by the IFMIS development project.

Lessons Learned

- User commitment and requirements identification are critical to the success of any management-information system development and implementation effort and should be prerequisites for any system development.

- Clear objectives and a schedule to achieve them are needed to effectively manage the work of contractors involved in developing systems and should be clearly articulated in contract documents.

- Management needs accurate and complete expenditure information to effectively manage project or program costs, and contracts should be written to require that information.

Recommendation

Our interim report provided recommendations and USAID is taking or planning actions that are consistent with those recommendations. Consequently, we make no new ones at this time, but will continue to assess the actions USAID is taking. We encourage USAID to continue to devote management attention to completing these actions to gain the greatest possible return for the substantial investment the United States has made in IFMIS. We will follow-up on USAID's progress later this year.

Management Comments and Audit Response

USAID strongly disagreed with some of our positions and some of the information in the report. It states we inappropriately describe IFMIS as achieving "limited functionalities" and that the system achieved a "high degree of functionality" prior to being shut down in 2007. It also states that a fully operational IFMIS will require continued support and, more importantly, GoI efforts to tailor the system to meet their needs in order to reach its full potential. Further, it takes issue with our position that U.S. funding for IFMIS cannot be fully calculated stating that USAID has provided a clear total expenditure for IFMIS. Moreover, USAID states that it is greatly concerned with our position that the cost-plus-fixed-fee type contract for IFMIS was a less than optimal contract mechanism and that this type contract, "suitable for research, or preliminary exploration or study and [where] the level of effort is unknown," was the exact mechanism required. USAID refers to information in our draft report that was from a March 2007 IMF report. We have deleted that information because the IMF report was for Iraqi use only.

We had discussed these matters with USAID officials during the course of our audit and had incorporated their views, where appropriate. We believe our positions are sound and the information in our report accurate. In summary, with regards to USAID's specific concerns mentioned above, we offer the following information.

- The description of IFMIS as "limited" is based on our analysis and the analysis of others.

- USAID states that a fully operational IFMIS will require GoI efforts to tailor the system to meet their needs. We agree, but as stated in this report, those needs should have been incorporated in the project design and not after 3 years of development effort.

- USAID did provide cost information on IFMIS, however, as we state in this report, the information was BearingPoint's estimates and not from the agency's official accounting records. Moreover, the BearingPoint estimates state the EG-I estimates "are illustrative only—Iraq I project did not track these costs separately."

- As we state in this report, the cost-plus-fixed-fee contract gives the contractor only a minimum incentive to control costs. Moreover, because it is more suitable to a research or preliminary exploration or study, in our view, it was not well suited to a specific system development and implementation effort.

USAID provided recent information on the GoI's support for IFMIS. We have incorporated that information in this report.

Appendix A—Scope and Methodology

We performed our initial work in the International Zone in Baghdad from March through September 2007 and our follow-up work in the Washington, D.C., area from October through December 2007, all in accordance with generally accepted government auditing standards.

To determine the U.S. cost and funding for the Iraq Financial Management Information System (IFMIS) we reviewed contract documents provided by the U.S. Agency for International Development (USAID) and the Iraq Transition Assistance Office (ITAO). We requested cost information from USAID and were provided BearingPoint, Inc. estimates as of May 2007. We did not validate the BearingPoint cost estimates. We also requested cost information from ITAO and were referred to the U.S. Corps of Engineers, which is responsible for maintaining the financial data for ITAO contracts. We received financial data as of October 2007 on the ITAO contracts from the U.S. Army Corps of Engineers Financial Management System. We did not validate the data.[12]

To determine the extent to which IFMIS development and implementation objectives and schedule were achieved, we reviewed and analyzed contract files, USAID memorandums and correspondence, BearingPoint monthly performance reports, Coalition Provisional Authority task orders, and International Monetary Fund (IMF) reports. Our attempts to understand specific objectives and time frames by means of discussions with USAID's Baghdad staff proved difficult because the staff members lacked detailed knowledge about contract deliverables and their status. USAID personnel in Baghdad referred all of our questions about the IFMIS system's status to BearingPoint. We also developed detailed questions for USAID concerning the contract objectives, deliverables, and time frames and were provided answers and documents in response to those questions.

To determine operational issues that impacted the success and acceptability of IFMIS, we reviewed IMF reports and memorandums and correspondence from U.S. advisors to Iraqi ministries and Iraqi officials. We held discussions with some of these individuals. We attended weekly meetings of the IFMIS steering committee, chaired by the Department of State Treasury attaché.

To determine the status of USAID's response to the recommendations in our October 2007 interim report, we requested and received that information from USAID.

[12] For more information on the reliability of data drawn from the U.S. Corps of Engineers Financial Management System, see GAO report 02-589, "Corps of Engineers Making Improvements but Weaknesses Continue," June, 2002.

Appendix B—Acronyms

CPA	Coalition Provisional Authority
EG	Economic Governance
GoI	Government of Iraq
IFMIS	Iraqi Financial Management Information System
IMF	International Monetary Fund
ITAO	Iraq Transition Assistance Office
USAID	U.S. Agency for International Development

Appendix C—Audit Team Members

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

Ziad Buhaissi

Robert Pelletier

Diane Recio

Roger M. Williams

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TO: Mr. Stuart Bowen, Special Inspector General for Iraq Reconstruction (SIGIR)

FROM: James Bever, Deputy Assistant Administrator for the Bureau for Asia and the Near East – USAID

DATE: January 15, 2008

SUBJECT: USAID Response to SIGIR Draft Audit Report on "Efforts to Implement a Financial Management Information System in Iraq" (SIGIR 08-007, Project 7010)

USAID appreciates the opportunity to provide comments on the draft SIGIR report regarding the Iraqi Financial Management Information System (IFMIS) effort. We are pleased to note that some of the minor technical details identified by USAID in previous reports have been incorporated into this final draft report. However, significant discrepancies and areas of disagreement still remain in this draft that do not adequately take into account information provided by USAID to SIGIR during a number of meetings, in conference calls, and through written documentation. We strongly recommend that SIGIR conduct a final review of the information provided in order to better reflect the facts surrounding the IFMIS effort. Please see the information below and in the attachments for additional information that should assist SIGIR in this review.

IFMIS Functionality. SIGIR makes several references about the system achieving "limited functionalities" before it was shut down in 2007. USAID reasserts that the IFMIS achieved a high degree of functionality prior to being shut down. In total, 112 of the 137 USAID targeted spending units, accounting for over 90% of the Iraqi budget, had been fully trained, connected to the system, and were entering data prior to the suspension of implementation efforts. Although a significant amount of work has been completed, there is more work to be done by both USAID and our Iraqi partners to achieve a fully operational financial management system.

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SIGIR cites IMF and World Bank concerns from 2005 regarding the limited functionality of the IFMIS. In response to their concerns, USAID worked with our GOI and donor counterparts and determined that the inclusion of a Crystal Reports functional add-on in 2005 would improve reporting. This illustrates one of the key benefits of the FreeBalance software used for the IFMIS—and a reason why this software is used from East Timor to the state of California. It can be tailored to incorporate new requirements as they arise even though it is an off-the-shelf system.

Similarly, SIGIR also cites a March 2007 IMF report on page 11 of the draft report noting that the "'IFMIS, as used currently, offers limited functionalities.'" As SIGIR notes earlier in the draft report, USAID stated that the original intent of the IFMIS effort was to provide an automated nationwide financial management information system, one that provided general ledger functionality that tracked expenditures and revenue against Iraq's Chart of Accounts. Other modules could be added separately; a fact noted by SIGIR in the draft audit. As mentioned previously to SIGIR, a fully operational IFMIS will require continued support and, more importantly, GOI efforts to tailor the system to meet their needs in order to reach its full potential. In this context, it is unclear as to why SIGIR continues to report this issue as a continuing problem. The flexibility of the FreeBalance software to incorporate additional modules / capabilities as needed will facilitate the achievement of this complete system.

IFMIS Funding. SIGIR alleges that US funding for IFMIS can not be fully calculated. USAID has provided a clear total expenditure for IFMIS of $22,093,386, a calculation based on (1) IFMIS procurement spending, (2) IFMIS-dedicated level of effort (LOE), and (3) apportioned costs for life support, security, and other indirect costs for the entire project distributed on a pro rata basis based on LOE levels. This calculation is necessary as the EG-1 and EG-2 contracts benefited from economies of scale. It is unclear to USAID what further degree of accuracy is required given that the USAID figure provided is in accordance with both Federal and USAID accounting guidelines and procedures. In addition, it is inappropriate to draw a comparison between USAID's IFMIS activity under a fully and openly

competed contract with the other non-USAID separate, sole-sourced contract noted by SIGIR.

Contracting Mechanism. USAID is greatly concerned with SIGIR criticisms that a Cost-Plus-Fixed-Fee (CPFF) contract was a less than optimal contract mechanism for the IFMIS effort. USAID has repeatedly explained that the CPFF contract mechanism provides for the ability to shift resources easily between different parts of large and complex projects and was very appropriate to the dynamic environment in Iraq. SIGIR even quotes the Federal Acquisition Regulation Subpart 16.306 which clearly states that this contract is "suitable for research, or preliminary exploration or study and [where] the level of effort is unknown." Given the complexity of the effort and the shifting working environment due to security and other factors, USAID asserts that the CPFF was the exact mechanism required; a choice proven in practice.

For the broad based economic reform programs and activities in question where shifting levels of commitment and effort were anticipated the contracting vehicle was, is and has in the case of IFMIS proven to be the ideal choice. The USG/USAID decision to suspend IFMIS while maintaining the flexibility to restart the effort now was possible precisely because of the contacting mechanism chosen.

GOI Support for the IFMIS. Several comments are also made in regards to the frustrations and lack of investment in this effort on the part of the GOI. USAID concedes that in a project of this scope undertaken in the extreme implementation environment of Iraq, frustrations will occur among all involved parties. SIGIR should not be surprised that such a significant change from the old, paper-based system in Iraq to a modern, transparent electronic system would be met with resistance by some of our GOI colleagues.

Despite the hesitation by some GOI representatives to such a fundamental change and the sometimes wavering GOI support for the IFMIS, GOI leadership's buy-in to the IFMIS effort is evidenced by the five ministerial orders endorsing and detailing the implementation of the IFMIS signed by

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the GOI. IFMIS-related activities are also included in three Stand-by-Arrangements negotiated between the GOI and the IMF. Although support for the IFMIS has ebbed and flowed due to changing personalities, the difficulty of the effort, and other issues, these commitments indicate a high level of commitment to the IFMIS by the GOI.

Finally, after a period of when GOI support for the IFMIS seemed less than vigorous, the GOI just reiterated their commitment to the IFMIS on January 14, 2008. At the request of the Iraqi Ministry of Finance, a Memorandum of Understanding was signed by the Minister of Finance and Acting Mission Director of USAID to restart the system. His Excellency Minister of Finance Bayan Jabr Al-Zubaidy signed an MOU making a substantial commitment of effort and resources by his Ministry to the restart of the system with USAID assistance. This document (see Attachment 2) clearly delineates both USAID and GOI responsibilities for completing the next phase of the IFMIS effort, and definitively illustrates GOI commitment to the system.

Summary. The IFMIS effort presented great challenges to both USAID and our Iraqi counterparts. The impact of security and the fundamental nature of the shift from a paper to an electronic system for an Iraqi government serving the needs of 26 million Iraqis pose challenges that cannot be underestimated. A thorough review by SIGIR of other countries where such a shift took place would provide additional perspective that is lacking in the current draft; particularly given that those shifts often took place in much more permissive environments.

In addition, the flexibility of the Cost-Plus-Fixed-Fee contracting mechanism and the FreeBalance software has allowed the project to continue and become more effective despite these hurdles. The continued commitment and diligent efforts of USAID and its implementing partner, and most importantly our Iraqi counterparts, will help bring the IFMIS effort to a positive conclusion.

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Attachment 1: **Specific USAID issues concerning findings of the SIGIR Audit Report; Effort to Implement a Financial Management Information System**

Award of the EG-1 and EG-2 Contracts
(Pages i para 2; 1 para 4)

According to the U.S. Agency for International Development (USAID), when instructed by the CPA to implement an Iraqi financial management information system, it entered into a broad-based contract with BearingPoint, Inc. for that purpose.

USAID entered into contract with BearingPoint for the purpose to: *create and develop growing, integrated and sustainable economic activity in Iraq. Assistance provided over 12 months to Iraq will emphasize a broad-based economic growth and economic opportunities.* This description is identified and elaborated on in the EG-1 contract. The IFMIS task, one of many under this contract, was identified after the EG-1 contract had been awarded.

Direction Provided by the Work-Plans
(Pages ii para 3; iii para 4; 7 para 2; 8-11 entire)

While deteriorating security conditions and competing demands no doubt adversely impacted IFMIS development, there was also a lack of clear direction based on user requirements. Neither the USAID EG-I and EG-II contracts nor BearingPoint's work plans provided that direction.

The USAID EG-1 and EG-2 work plans, followed by BearingPoint, did provide clear direction for implementing an activity in a complex and changing environment despite SIGIR's assertions. As noted previously, the contracts determined the scope while the work plans served as management documents. This legal and appropriate method of management enabled USAID to change a contractor's work plan to address changes in priority or

developments on the ground, without the delays and cost increases that would follow regularly renegotiating a contract.

Calculating U.S. Funding for IFMIS
(Pages ii para 4; iii para 1-2; 4-6 entire)

U.S. funding for IFMIS cannot be fully calculated... The two ITAO contracts identify IFMIS-related costs, but the USAID contracts do not differentiate IFMIS related costs from others.

As shown by the ability to determine a cost based on (1) IFMIS procurement spending, (2) IFMIS-dedicated LOE, and (3) apportioned costs for life support, security, and other indirect costs for the entire project distributed on a pro rata basis based on LOE levels, the USAID funding for IFMIS can indeed be calculated. This calculation is necessary as the EG-1 and EG-2 contracts benefited from an economy of scale. Life support, security, and other indirect costs were shared across the entire EG-1 and EG-2 contracts, rather than facing the increased administrative and indirect costs (not to mention management difficulties) of awarding a new contract for each task order.

Use of Cost-Plus-Fixed-Fee Contracts
(Pages ii para 4; iii para 2; 4-6 entire)

Both USAID EG-I and EG-II contracts were cost-plus-fixed-fee level of effort contracts, a type that provides less cost risk to the contractor... IFMIS, in our view, was more than a research or preliminary study effort; it was a system development and implementation effort.

USAID made the right choice in choosing this type of contract. Cost-plus-fixed-fee level of effort contracts provide maximum flexibility needed for operating in the complex and changing Iraqi environment. As noted previously, the EG-I and EG-II contracts were not awarded solely for the purpose of implementing the IFMIS activity, but were wide reaching

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economic reform and development contracts requiring the scope and flexibility to adjust to changes on the ground and needs of the CPA and U.S. Embassy. The IFMIS activity, a system development and implementation effort, was one small and relatively minor part of these contracts.

We are aware that in general SIGIR does not favor cost-plus-fixed-fee level of effort contracts, but this type of contract is an authorized method of contracting under the Federal Acquisition Regulations and it provides for tracking of costs by contract line item. The draft report does not adequately explain why the use of this contracting method was incorrect in this case.

Technical Issues: The Development of Reports
(Pages iv para 1; 7 para 3; 11 para 6; 12-14 entire)

...The IMF stated that significant efforts would be required before IFMIS could be relied upon to generate reports that address Iraqi needs.

As noted in the December 2007 response to SIGIR, the IFMIS is designed to be modular. Advanced reporting features were added with the addition of a Crystal Reports functional add-on in 2005, addressing concerns voiced by the GOI and the IMF. We are unclear as to why SIGIR continues to report this issue as a continuing problem.

Technical Issues: Manual Entry and Data Quality
(Pages iv para 1; 7 para 3; 11 para 6; 12-14 entire)

Spending units were not user friendly. Data had to be entered one record at a time, and some ministries were obligated to enter thousands of records. This process was burdensome and subject to data errors.

For nearly any automated record keeping system, at some point data must be entered manually. Manual data entry, performed by people, is inherently subject to human error.

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Technical Issues: The Legacy System and Ministries of Defense and Interior
(Pages iv para 1; 7 para 3; 11 para 6; 12-14 entire)

SIGIR also found that as alternatives to IFMIS, the Ministry of Finance continued to use legacy systems, while other ministries, such as Defense and Interior, had developed their own financial management systems.

As noted several times to SIGIR and as finally reported at the bottom of page 13 and top of page 14 of the audit, parallel use of the legacy system is standard operating practice in the installation of financial management information systems. This step ensures functionality, accuracy, and assists with change management. This step was also identified in at least one of the USAID work plans. After the kidnapping of five USAID contractors and the suspension of the IFMIS implementation, the Government of Iraq did continue to use the legacy system.

As noted several times to SIGIR and as finally reported at the bottom of page 13 of the audit, USAID is statutorily prohibited from providing assistance to foreign military or security forces. It was determined with the CPA and Departments of Defense and Treasury that USAID would not install IFMIS at the Ministries of Interior or Defense for this reason, and that the US Department of Defense would install comparable systems. The GOI could then easily take steps, over time, to integrate these ministries. Implying that this gap was from some oversight or that some Iraqi ministries other than Defense and Interior had "developed their own financial management systems" is inaccurate.

Also, clarification is necessary on page 13 of the draft SIGIR report. It says that, despite the restrictions on USAID assistance to the MOD and MOI, "Spending units were nonetheless installed in the two ministries." The impression left is that USAID installed these spending units. That is not correct so further clarification by SIGIR is needed.

MEMORANDUM OF UNDERSTANDING

BETWEEN

THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

ON BEHALF OF

THE GOVERNMENT OF THE UNITED STATES OF AMERICA

AND

THE MINISTRY OF FINANCE

ON BEHALF OF

THE GOVERNMENT OF THE REPUBLIC OF IRAQ

FOR ASSISTANCE TO FINALIZE THE IMPLEMENTATION OF THE IRAQI FINANCIAL MANAGEMENT INFORMATION SYSTEM (IFMIS)

ARTICLE 1. PURPOSE

Section 1.1. The Government of the United States of America, acting through the United States Agency for International Development ("USAID"), and the Government of the Republic of Iraq, acting through the Ministry of Finance (the "MOF" or the "Ministry") (USAID and the Ministry of Finance are hereinafter referred to as the "Parties") wish to cooperate in a mutual effort to implement an Iraqi Financial Management Information System.

Section 1.2. USAID wishes to furnish and the Ministry wishes to receive in-kind assistance to support the Program. The Ministry will also provide on-going support to this effort and will commit itself to sustaining projects funded in whole or in part with USAID resources. Accordingly, the Parties have concluded the present Memorandum of Understanding ("MOU") to set forth their understandings with respect to their undertakings in support of the stated purpose.

ARTICLE 2. NATURE OF THE ASSISTANCE

Section 2.1. USAID assistance is intended to provide technical support to the program. USAID anticipates that this assistance will be provided from 1 January 2008 – 02 September 2009, although these dates may change subject to the rate of implementation. The support USAID intends to provide to the Ministry pursuant to this MOU will, at USAID's discretion, be furnished through grant and/or contract instruments USAID enters into with private organizations (referred to as "implementing partners.") Those actions that USAID intends to take pursuant to this MOU may be taken either directly by USAID or by a designated implementing partner.

USAID will keep the Ministry informed of the specific nature of the assistance it will provide and seek Ministry input whenever possible. USAID will periodically communicate with the Ministry through letters to keep Ministry leadership informed of progress and changes in the Program. Likewise, the Ministry will periodically report in writing to USAID its assessment of the program's progress. Specifically, the Parties anticipate providing the following in support of the program:

The Ministry of Finance (MOF):

- The MOF will reestablish VSAT Internet connectivity to all spending units by making any outstanding payments, and ensure sustainability by budgeting for ongoing payments. Connectivity charges will be the sole responsibility of the MOF. The schedule of connectivity will be determined by a schedule provided by the MOF as an annex to this document.

Phase I – IFMIS Restart and System Management

- MOF staff with the assistance of local project staff will remove the IFMIS servers from the MOF's IT Directorate and arrange transport to the USAID EG II camp as soon as possible so that USAID project technicians can work with Freebalance to resolve outstanding technical issues.
- MOF personnel may, at USAID's discretion, stay temporarily at the USAID EG II camp to better work through technical issues with USAID advisors. This will allow the Parties to work together without interruption. USAID will provide accommodation, and per diem through the EGII contract in accordance with United States Government expense guidelines. It is anticipated that up to six MOF staff will reside at the Project site with an additional two staff working on site daily.
- The MOF will restart the IFMIS server.
- When all system technical issues are resolved, the MOF will relocate the IFMIS back-up servers to a new data center in the Adnan Palace to facilitate USAID advisor access. The backup system will provide full post disaster recovery functionality for the entire IFMIS system.

Phase II – Execution of Orders Signed by Minister Bayan Jabr Al-Zubaidy on

February 27, 2007:

- In support of the Order previously signed by the Minister of Finance, the MOF will request that the Council of Ministers issue an order to make IFMIS the official system of the Government of Iraq's budgetary, financial and accounting records for financial year 2009, after reconciling functionality with the legacy sytem.
- The MOF will reaffirm its commitment to work with the USG to immediately activate the Performance Budgeting and Procurement Modules of the IFMIS.
- The MOF will fully execute the Ministry of Finance budget allocated to complete the implementation of the IFMIS. This will include expanding the system to include up to 250 sites (site preparation will be joint MOF/USAID responsibility-MOF to provide hardware, USAID to provide software).
- MOF will provide USAID with a full list of the current legacy system to ensure that the IFMIS system matches the reporting functionality of the legacy system including the International Monetary Fund required reports.

USAID:

USAID intends to provide the following assistance to the MOF:

- USAID advisors to work with the MOF to identify and correct any currently identified technical problems with the IFMIS system and enable the system to absorb 250 sites;
- USAID advisors to provide technical support for restarting the IFMIS servers and for resuming VSAT Internet connectivity for IFMIS sites previously funded under the program (USAID will not pay connectivity charges or equipment charges going forward);
- USAID advisors will facilitate introductions and relationship development for the MOF IT Directorate and appropriate functional staff with all software and hardware vendors. Where possible, project staff will invite vendor staff to Iraq or when necessary will seek out alternative meeting methodologies such as, but not limited to, video conferencing. This will allow the MOF to assume an ownership role over the system software.
- An implementing partner to work with the MOF to develop additional training programs to engender greater understanding of the IFMIS and its abilities. These efforts will be designed to build capacity in the MOF and other Government of Iraq (GOI) entities to take full advantage of the program's deliverables.
- USAID Advisors to work to develop a workable offline data-entry tool;
- USAID Advisors to complete the installation of Crystal Reports; and
- An implementing partner to provide train-the-trainer workshops to foster sustainability for program gains and ensure GOI buy-in going forward.

The IFMIS will be considered completed when the USAID advisors have addressed those technical issues that have been formally identified and has returned the IFMIS server

equipment to the MOF. While USAID may continue to offer limited technical assistance aimed at promoting capacity at the MOF to use, maintain and update their system – the GOI will assume full ownership of the computer system and the software at this time. As such, the MOF will have the sole obligation to fund upkeep and maintenance costs once USAID has transferred the IFMIS system to the MOF as 'completed'.

Timing:

The Parties intend that the undertakings described in this MOU will be accomplished according to the timeframes described in Annex A hereto.

ARTICLE 3. GENERAL PROVISIONS

Section 3.1. **Availability of Funds.** This MOU is intended to set forth the mutual understandings and commitments of the Parties. The Parties agree to cooperate in good faith to achieve the objectives of the MOU. This MOU is not, however, intended to be legally binding document. This MOU also does not constitute an obligation of funds by the U.S. Government. Funding for any activities by USAID in furtherance of the purposes of this MOU will be subject to the availability of funds for such purposes, as well as overall U.S. Government funding priorities.

Section 3.2. **Compliance with Law and Regulations**. USAID will obligate, commit, and expend funds and carry out operations pursuant to this MOU only in accordance with the applicable laws and regulations of the United States. The Ministry will carry out its activities contemplated by this MOU in accordance with applicable laws and regulations of Iraq. If at any time either Party determines that continuing this MOU will violate or cause it to violate any applicable legal or regulatory restriction that Party may withdraw from and terminate this MOU immediately upon notice to the other Party.

Section 3.3. **Publicity**. The Parties agree to cooperate to give appropriate publicity to the assistance as a program to which the Government of the United States has contributed.

Section 3.4. **Exchange of Information**. USAID and the Ministry shall provide each other with such information as may be needed to facilitate provision of the assistance and to evaluate the effectiveness of this assistance. In addition, the Parties may use jointly agreed letters to confirm their mutual understandings with respect to implementation of this MOU, including changes in Section 2.1.

Section 3.5. **Authorized Representatives**. The Parties shall be represented by those holding or acting in the offices held by the signatories to this MOU. Each Party may, by written notice, to the other, identify additional representatives authorized to represent that Party for all purposes other than executing formal amendments to this MOU. Each Party shall notify the other, in writing, of changes in its authorized

representatives.

Section 3.6. **Amendment and Modification**. This MOU may be amended or modified at any time by written agreement of the Parties.

Section 3.7. **Expiration and Termination**. Either Party may terminate this MOU at any time by providing the other Party with written notice.

If USAID determines that a gratuity in any form has been offered or given to a contractor or grantee or its agents or representatives for the purpose of securing favorable treatment related to the Program, USAID reserves the right to take appropriate, immediate action, including, but not necessarily limited to, immediate termination of this MOU.

Section 3.8. **Disputes**. Any disputes between the Parties arising under this MOU will be resolved through consultations and negotiations. In no event will any disputes be referred to a third party, or to a judicial process. If the representatives of the Parties primarily responsible to implementing this MOU are unable to resolve a dispute the Parties will elevate the matter to the next available management level within their respective organizations.

Section 3.9. **Language.** This Memorandum of Understanding is prepared in English and Arabic. In the event of ambiguity or conflict between the versions, the English language version will control.

Section 3.10. **Effective Date**. This Memorandum of Understanding shall be effective when signed by both Parties.

GOVERNMENT OF THE UNITED STATES OF AMERICA

BY: Denise A. Herbol

NAME: Denise Herbol

TITLE: Acting Mission Director

DATE: January 12, 2008

GOVERNMENT OF IRAQ

BY: _____

NAME: BAKER JABOR ALZUBIDY

TITLE: MINISTER OF FINANCE

DATE: 14/01/2008

Annex A

Implementation Timing

Once the appropriate approvals are obtained, the Project intends to arrange for the purchase of the necessary licenses to operate the Freebalance software. The licenses will be purchased for calendar year 2008. The MOF, with assistance from local project staff, will then arrange to transport the IFMIS servers to the Project camp where they will be worked on by Project advisors in order to correct any technical faults. This process will require approximately 30 days to accomplish (from date of approval).

The IFMIS equipment will remain in the Project camp for approximately 60 days while technical issues are resolved thereby restoring the system to a fully functioning status. At the conclusion of this time period, the fully functioning system will be returned to the MOF and the IFMIS will be re-started. Over the following six months the system will demonstrate the capability to reconcile the IFMIS records with those produced by the legacy system. At the successful conclusion of this four month period, the system will be considered to be 'complete' and will be transferred to the GOI. The FMIS will be considered officially accepted by the GOI if no correspondence is received indicating unresolved problems with the system during the six month period.

No later than April 30th, 2008, the MOF will restore internet connectivity to the FMIS sites and will continue to procure and equip all remaining 'spending units' at the expense of the GoI.

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Congressional Affairs	Hillel Weinberg Assistant Inspector General for Congressional Affairs Mail: Office of the Special Inspector General for Iraq Reconstruction 400 Army Navy Drive Arlington, VA 22202-4704 Phone: 703-428-1059 Email: hillel.weinberg@sigir.mil
Public Affairs	Kristine R. Belisle Director for Public Affairs Mail: Office of the Special Inspector General for Iraq Reconstruction 400 Army Navy Drive Arlington, VA 22202-4704 Phone: 703-428-1217 Fax: 703-428-0818 Email: PublicAffairs@sigir.mil