QUARTERLY UPDATE TO CONGRESS

2207 REPORT

JULY 2004
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Executive Summary

Section 2207 of the Emergency Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004 (Public Law 108-106) requires the Office of Management and Budget (OMB) to submit a report to Congress every 90 days that updates the estimates and assumptions for the $18.4 billion appropriated in this Act for the Iraq Relief and Reconstruction Fund (IRRF). OMB submitted the first financial plan to Congress on January 5, 2004 and the first update on April 5, 2004. This update highlights the changes from the April report and the developments that have set the stage for Iraqi sovereignty. The new country team, led by Ambassador Negroponte, will examine the priorities and programs funded by the IRRF and will consult with Congress concerning any changes suggested by their review.

The New Sovereign Iraq

The Coalition Provisional Authority (CPA) transferred authority to the sovereign Iraqi Interim Government (IIG) on June 28, 2004. On this same day, the Coalition Provisional Authority disbanded, and it will not be replaced. Iraqis will now govern their own affairs. Ambassador John Negroponte, who presented his credentials to Iraqi President al-Yawar on June 29th now leads our new embassy in Baghdad. The embassy will have the same purpose as any other American embassy, to assure constructive relations with a sovereign government; the ambassador and embassy will also oversee our reconstruction activities. The Iraqi people now have a sovereign government, but the work of the U.S., the coalition partners, and the Iraqi people to build a strong, democratic Iraq continues.

On May 24, 2004 President Bush outlined a plan to help Iraq achieve democracy and freedom: to transfer authority to a sovereign Iraqi government; to help establish security; to rebuild Iraq's infrastructure; to encourage more international support; and to move toward a national election that will bring forward new leaders selected and empowered by the Iraqi people. We have taken the first step by handing over authority to a sovereign Iraqi government. In partnership with Iraqi leaders and other nations, we continue to make progress on the four other aspects of the plan.

Transfer of Authority

After close consultation with the UN Special Envoy, Lakdar Brahimi, CPA transferred authority to the IIG, which is comprised of a group of Iraqis that possess the talent, dedication, and determination to guide Iraq through the challenges that lie ahead. This is the first step in the President’s plan to support the Iraqi effort to secure a free and democratic nation. The IIG has assumed full sovereignty and will oversee all ministries and all functions of the Iraqi state. Those ministries report to Prime Minister Allawi, who is responsible for the day-to-day operations of Iraq's interim government. The government also includes Iraq's interim President, Ghazi Al-Yawar, two deputy presidents and a 33-member cabinet that reflects new leadership, drawn from a broad cross section of Iraqis. Five members of the cabinet were officials serving in regional government institutions throughout Iraq and six are women. The vast majority of government ministries have new ministers. The primary tasks of this new interim government are to prepare Iraq for a national election no later than January, 2005 and to provide the security that will make
that election possible. That election will choose a transitional national assembly, the first freely elected national governing body in Iraq's history.

Under Resolution 1546, the UN Security Council unanimously endorsed the formation of the IIG, the holding of elections, and the status of the multinational force and its relationship to the IIG. The Security Council decided that the Special Representative of the Secretary-General and the United Nations Assistance Mission for Iraq (UNAMI), as requested by the Iraqi Government, should play a leading role in, among other tasks, the electoral process, the development of effective civil and social services, and the coordination and delivery of reconstruction, development, and humanitarian assistance.

**Security**

Shortly after the last report, there was a marked escalation in attacks by insurgent forces. In response, the Department of Defense re-evaluated training, equipment, and operational plans for security forces in Iraq. In early June, Lieutenant General David Petraeus was deployed to launch a new, comprehensive effort to reorganize and rebuild the five Iraqi security forces (the Iraqi Armed Forces, the Iraqi National Guard (ING) – formerly known as the Iraqi Civil Defense Corps, the Iraqi Police Service, the Department of Border Enforcement, and the Facilities Protection Service). General Petraeus has accelerated the delivery of equipment and additional resources from the Development Fund for Iraq have been set aside to meet emerging requirements.

The current status of plans to rebuild Iraqi security services is:

- The Iraqi Armed Forces are on track to complete basic training of 27 infantry battalions by this winter, and deliveries of basic soldier equipment should be complete by then. Officer and non-commissioned officer cadre training for the 27 battalions is largely complete. Four battalions have completed integration training in preparation to operate with multinational brigades throughout the country. Three more battalions are in training.
- The Iraq National Guard has fielded 41 of an eventual 45 battalions with at least 75 percent manning and are actively participating in combined operations with Coalition Forces and the IPS.
- The Iraqi Police Service (IPS) is functional nationwide. About 120,000 officers are on the payroll, but not all personnel on duty have received sufficient police training, or are fully equipped to be mission capable. The immediate focus is to reconstitute and reorganize the IPS and accelerate efforts to equip and train the force.
- The Iraqi Department of Border Enforcement has nearly 90 percent of its required personnel trained and on duty.
- The Facilities Protection Service has approximately 74,000 Iraqis on board.

**Rebuild Iraq's Infrastructure**

The third step to advance the President’s plan is to continue assistance in rebuilding Iraq's infrastructure. However, security problems have slowed reconstruction. Disruptions due to attacks
and threats against drivers and vehicles have slowed the delivery of construction materials and supplies; attacks and threats have also been made against technical experts repairing, installing, and commissioning specialized equipment, particularly impacting the pace of power generation projects.

A number of firms supporting the electrical sector have either withdrawn staff from Iraq or have severely limited their movement beyond secured facilities. As a result, the June 2004 goal of producing 6,000 megawatts has been delayed. Likewise, because of sabotage to Iraq’s oil infrastructure, exports of crude oil fell from 1.8 million barrels per day (b/d) in March and April to 1.4 million b/d in May compared with an export goal of 1.6 b/d by April 1 and 2.2 million b/d by the end of 2004. More specifically, attacks on June 14-15 against two key oil pipelines in the Basra area halted all exports until June 21. Full exports of 1.8 million b/d were not restored until June 26.

The reconstruction effort is moving forward. With a combination of IRRF assistance and funds from the Iraqi budget, the coalition has helped Iraqis rebuild schools and refurbish hospitals and health clinics, repair bridges, upgrade the electrical grid and ports, and modernize the communications system.

- The total number of telephone subscribers in Iraq is over 1.2 million as of June 18, an increase of 200,000 since April, and over 49 percent greater than number of active subscribers pre-war;
- Around 85 percent of Iraqi children have been immunized;
- Iraqi students are completing their academic year with national exams without incident and over 2,500 schools have been rehabilitated; and
- Iraqi oil production has earned revenues of over $7.5 billion so far this year, which is primarily being used to finance Ministry operating budgets and reconstruction activities in other sectors, including oil, electricity and security.

**Encourage International Support**

The fourth step in the President’s plan is to encourage international support. Today, many nations have pledged to support Iraq’s transition to democracy. The international community has begun following up on its pledges at the October 2003 Madrid International Donors Conference on Iraq. Pledges for 2004-2007 assistance from non-U.S. donors at Madrid totaled over $13 billion, including loan assistance. Over 20 countries have disbursed reconstruction assistance totaling over $1.1 billion as of June 2004 (six months into the 4-year pledge period). Appendix 2 provides more detail on international contributions to Iraq reconstruction.

In addition, Iraq’s Governing Council approved a new law that opens the country to foreign investment from outside the region for the first time in decades. Iraq has liberalized its trade policy, and today an Iraqi observer attends meetings of the World Trade Organization. Due to the efforts of former Secretary of State James Baker, many of Iraq’s largest creditors have pledged to forgive or substantially reduce Iraqi debt incurred by the former regime. To this end, on June 18, 2004 the State Department proposed legislation that would provide authority to the Administration to forgive Iraq’s debt to the United States.
Elections

The fifth step is free, national elections, to be held no later than next January. A United Nations team, headed by Carina Perelli, has formed an Iraqi independent election commission that will oversee an orderly, fair, and accurate national election. In that election, the Iraqi people will choose a transitional national assembly, the first freely-elected, truly representative national governing body in Iraq's history. This assembly will serve as Iraq's legislature, and it will choose a transitional government with executive powers. The transitional national assembly will also draft a new constitution, which will be presented to the Iraqi people in a referendum scheduled for the fall of 2005. Under this new constitution, Iraq will elect a permanent government by the end of next year. The U.S. government is strongly committed to supporting the electoral process in Iraq. Ambassador Negroponte’s review of IRRF spending priorities will look closely at current funding in support of elections.

The Iraq Reconstruction Effort

This report discusses key accomplishments to date that have been funded from three principal sources: U.S. appropriated funds from the FY 2003 and FY 2004 supplementals; the Iraqi budget, funded through the Development Fund for Iraq (DFI); and international contributions. Therefore, Appendix I of this report incorporates overall accomplishments, attributable to all sources of funding, under each Project Code. We have not attempted to separate out the accomplishments that are specifically attributable to the FY 2004 IRRF funds, since it is the total impact of all available funds that will create the conditions for a stable and prosperous Iraq.

The past quarter has witnessed changes in the situation in Iraq, and consequent changes in investments in Iraq’s infrastructure. While CPA did not make major changes to the allocation of the IRRF among sectors and projects since the April 2207 report, unexpected deposits to the Development Fund for Iraq (DFI), primarily from the United Nations escrow account for Oil for Food programs, have allowed CPA, in consultation with the appropriate Iraqi ministries, to undertake new investments above those funded in the U.S. Supplemental and the revised Iraqi budget.

Changes in the IRRF allocation since April include:

• A realignment of $40 million within the security sector to establish a new project – the Iraqi Security Forces Quick Response Program (project code 26000) – of the Office of Security Transition – Iraq (OST-I, formerly Office of Security Cooperation). DoD notified the Congress of this realignment on June 24, 2004. To fund this project, CPA reduced funds from the Border Enforcement project by $20 million and the Facilities Protection Services (FPS) project by $20 million. These funds are available because resources from the Development Fund for Iraq were used to purchase some of the Border Enforcement equipment requirements and the costs for FPS requirements were less than projected. (See Appendix I for more details).

• A re-phasing of IRRF resources from FY 2005 into the 4th quarter of FY 2004 in the Private Sector Development sector. (See Appendix I for more details);
• A plan to fund FY 2004 operating costs of agencies implementing IRRF projects; and

• A revised set of offsets required to fund a transfer of $184 million from the IRRF to the State Department to support operating costs of the U.S. mission in the 4th Quarter (a transfer discussed in the April report).

**IRRF Program Management**

As noted, Ambassador Negroponte and his team will review the priorities and programs funded by the FY 2004 IRRF. Based on this review, the State Department will consult with Congress on any recommended changes to the spending plan presented in this report.

The transition to Iraqi sovereignty requires that the Chief of Mission have the ability to respond to new relief, reconstruction, and capacity building challenges as they arise. The FY 2004 Supplemental Appropriations Act limits transfers of funds between sectors in the IRRF to a total of 10 percent out of and 20 percent into any sector, with a one-time emergency authority to increase one sectoral allocation by an additional 20 percent. For certain sectors, such as private-sector development, the Administration has already transferred the maximum amount into the sector (although the one-time additional transfer authority has not yet been tapped). These transfer restrictions may limit the ability of the Administration to respond to the rapidly evolving reconstruction needs in Iraq. On June 18, 2004, the State Department proposed legislation to the Congress to lift the restrictions on funding transfers between sectors, which will give the Administration the flexibility to redirect resources as needed, in consultation with Congress.

In the meantime, agencies have obligated $2.398 billion of the $2.475 billion appropriated in April of 2003 for the first Iraq Relief and Reconstruction Fund and disbursed $1.438 billion. Of the $18.4 billion appropriated in the FY 2004 Supplemental, $11.12 billion has been apportioned through the 3rd quarter to various agencies for a variety of projects. As of June 22, 2004, agencies have obligated approximately $5.3 billion, representing almost 48 percent of the apportioned amount and almost 29 percent of the total appropriated level for Iraq. Obligations have more than doubled since the April report. Of the $5.3 billion obligated, $3.6 billion is for construction programs and $1.7 billion is for non-construction programs. As with other programs, actual disbursement of funds has lagged behind obligations. As of June, 22, 2004, implementing agencies have disbursed $365.5 million.\(^1\) The table on page 17 provides an updated spending plan for the FY 2004 IRRF.

In January 2004, CPA initiated a competitive process to award reconstruction contracts consistent with statutory guidance provided in the FY 2004 Supplemental. In March 2004, CPA awarded $5 billion in contracts. As contractors mobilized and deployed and task orders were developed, violence in Iraq increased. These challenges continue to impede the actual work from being executed and completed on schedule.

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\(^1\) An apportionment is defined as a plan, approved by OMB, to spend resources provided by law. An obligation is a binding legal agreement for a specific amount and purpose. A disbursement is defined as an actual payment (check goes out the door) for goods/services received.
IRRF Administrative Expenses

Agencies implementing IRRF programs require resources to fund their operations. The Congress recognized this need and in the FY 2004 Supplemental Appropriations Act provided authority for the Administration to use up to 10 percent of the funds appropriated to the Iraq Relief and Reconstruction Fund (IRRF) to fully cover the cost of implementing these funds:

Provided further, That of the funds appropriated under this heading, up to 10 percent of such funds that are obligated, managed, or administered by an agency of the United States Government, other than the Coalition Provisional Authority, shall be made available to such agency to fully pay for its administrative expenses:

In the Statement of Managers accompanying the Conference Report for this Act, House Report 108-337, the Conferees made clear their intention that agencies implementing reconstruction efforts be “fully financed for administrative expenses” through this authority:

The managers expect the Office of Management and Budget to ensure that agencies supporting the CPA and the reconstruction effort in Iraq are fully financed for administrative expenses through the funds appropriated in the Iraq Relief and Reconstruction Fund, in an amount equal to up to 10 percent of programs administered.

Consistent with this authority, the agencies that are implementing the IRRF -- the Department of Defense, the U.S. Agency for International Development, the Department of State, the Department of the Treasury, and the U.S. Institute for Peace – plan to use $290.4 million, or 1.6 percent of the IRRF, for FY 2004 program implementation. Funds will not be transferred from the IRRF to other accounts but will remain in the project lines as included in this report. Agencies will use the funds for program implementation requirements, including:

- All costs associated with direct-hire staff where the only role of such staff is implementation of the IRRF;

- All costs associated with contractors (including personal service contractors) hired to manage an agency’s IRRF program;

- All other costs not directly related to a specific project. For example, overall program management and evaluation, which cuts across numerous specific projects, is considered a valid program implementation cost, while costs related to management of a specific construction project (e.g., an on-site construction manager) are considered direct program expenses; and

- All costs associated with security of program implementation personnel.
The table below shows FY 2004 program implementation costs by agency, by sector.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Total Allocation</th>
<th>DoD</th>
<th>AID</th>
<th>State / USIP</th>
<th>Treasury</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Security and Law Enforcement</td>
<td>3,235.0</td>
<td>66.1</td>
<td>0.0</td>
<td>5.2</td>
<td>0.0</td>
<td>71.2</td>
</tr>
<tr>
<td>Justice, Public Safety</td>
<td>1,484.0</td>
<td>18.5</td>
<td>6.4</td>
<td>1.5</td>
<td>0.0</td>
<td>26.3</td>
</tr>
<tr>
<td>Electric Sector</td>
<td>5,464.5</td>
<td>37.4</td>
<td>16.3</td>
<td>0.0</td>
<td>0.0</td>
<td>53.7</td>
</tr>
<tr>
<td>Oil Infrastructure</td>
<td>1,701.0</td>
<td>48.2</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>48.2</td>
</tr>
<tr>
<td>Water and Sanitation</td>
<td>4,246.5</td>
<td>15.2</td>
<td>7.1</td>
<td>0.0</td>
<td>0.0</td>
<td>22.2</td>
</tr>
<tr>
<td>Transportation and Telecommunications</td>
<td>499.5</td>
<td>13.3</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>13.3</td>
</tr>
<tr>
<td>Roads, Bridges</td>
<td>367.5</td>
<td>7.5</td>
<td>0.2</td>
<td>0.0</td>
<td>0.0</td>
<td>7.7</td>
</tr>
<tr>
<td>Health Care</td>
<td>786.0</td>
<td>12.4</td>
<td>0.5</td>
<td>0.0</td>
<td>0.0</td>
<td>12.9</td>
</tr>
<tr>
<td>Private Sector Development</td>
<td>183.0</td>
<td>0.0</td>
<td>2.1</td>
<td>0.0</td>
<td>0.0</td>
<td>2.1</td>
</tr>
<tr>
<td>Education, Democracy</td>
<td>259.0</td>
<td>0.5</td>
<td>1.9</td>
<td>0.4</td>
<td>1.0</td>
<td>3.7</td>
</tr>
<tr>
<td>USAID Admin Direct Approp.</td>
<td>29.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>29.0</td>
</tr>
<tr>
<td>1% IRRF transfer for US Mission</td>
<td>184.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>18,439.0</strong></td>
<td><strong>219.0</strong></td>
<td><strong>63.4</strong></td>
<td><strong>7.0</strong></td>
<td><strong>1.0</strong></td>
<td><strong>290.4</strong></td>
</tr>
</tbody>
</table>

Operating Expenses of the U.S. Mission in Iraq. The April 2007 report indicated the intention of the Administration to transfer $184 million from the IRRF to fund the operating costs of the U.S. mission in Iraq. This transfer is permitted in the FY 2004 Supplemental Appropriations Act. The April report noted that these funds would come from projects in the water sector. This report presents another approach to funding the $184 million transfer. Rather than reducing funds solely from the water sector, this report proposes to reduce un-apportioned funds in all sectors by a pro-rata share (approximately 2.5 percent) to cover the $184 million transfer. Because the water and electricity sectors are two of the largest sectors and have the largest un-apportioned balances, these sectors will be charged $85.5 million and $74.5 million, respectively. Adjustments to sectors and projects to cover this transfer is shown in the IRRF allocation table on page 17 and highlighted in the appropriate sections of Appendix I.

The Development Fund for Iraq

As noted in earlier 2207 reports, the United Nations Security Council Resolution (UNSCR) 1483 established the Development Fund for Iraq (DFI). The DFI was set up to protect Iraq’s overseas assets and oil revenue from seizure or attachment by creditors. The balances in the DFI come from multiple sources, of which the two most important are proceeds from oil export sales and transfers by the United Nations in 2003 from uncommitted balances in Iraq’s Oil-for-Food program account.

The DFI is the primary source of funds for the operation of the Iraqi Government. According to UNSCR 1483, the DFI may only be used for humanitarian assistance, economic reconstruction, Iraqi civil administration, and other purposes benefiting the Iraqi people (such as establishing
security forces with training and equipment). The new UNSCR 1546 gives the Interim Iraqi Government authority over the DFI.

Since the April report, the DFI received $2.5 billion in additional revenue from the Oil for Food program. CPA, in conjunction with relevant Iraqi ministries, allocated these funds for long-term rebuilding and investment, primarily in the oil, electric, and security sectors. These funds were used to address additional security needs, as well as to add new oil and electric sector projects that were not covered by the original IRRF funds. Additional funds for the Security sector allowed various security forces, primarily the Police and the Iraqi Armed Forces, to address new concerns that arose in response to recent events, as well as shortfalls from previous requirements. Some of these requirements included reconstruction of police stations in four cities.

Of the additional $2.5 billion in Oil for Food revenue:

- $1 billion is for security: $500 million will be used to provide additional equipment for Iraqi security services such as the Iraqi Police Service, the Iraqi National Guard, Border Enforcement, and the Facilities Protection Service and to equip training facilities for these services; and $500 million is being used for the Commander’s Emergency Response Program (CERP) and a new program, the Accelerated Iraqi Reconstruction Program (AIRP), a CPA effort designed to conduct reconstruction projects with large economic impact in specific cities. (Prior to receipt and allocation of the additional OFF revenue, the DFI had already included $500 million for security which is being used to procure equipment for the Iraqi Armed Forces);
- $200 million is for the Public Distribution System in order to ensure sufficient food rations for Iraqis this year;
- $330 million is for reserves that will address the long-term needs of Iraq, including $125 million for a revenue stabilization fund, $180 million to provide a down payment for the potential claims against the Iraqi Property Claims Commission, and $25 million to compensate Iraqi victims of abuse by the Saddam Hussein regime; and
- $955 million for expenditures providing support to revenue-generating sectors ($460 million for oil infrastructure projects), critically-needed services ($315 million for electricity infrastructure projects), and investments in Iraq’s future ($65 million for agriculture investments, $65 million for vocational training aimed at getting young Iraqis off the streets and into literacy and/or vocational training and placement programs, $50 million for State-Owned Enterprises).

The DFI is funding two efforts that are proving critical to the reconstruction effort: The Commander’s Emergency Response Program (CERP) and the Accelerated Iraqi Reconstruction Program (AIRP).

The Commander’s Emergency Response Program (CERP). The Commander’s Emergency Response Fund (CERP) was described in the April report. The CERP continues to be a very effective program enabling quick responses to urgent humanitarian relief and reconstruction
requirements, which has built trust and support for the United States at the grassroots level. This program has allowed the local population in various communities to see immediate results. Since the April report, CPA, in consultation with the appropriate Iraqi ministries, provided an additional $131 million of DFI resources to fund CERP. In total, $680 million has been provided to date for CERP from three sources: Iraqi seized assets ($179 million), the DFI ($361 million—including the $131 million from additional OFF revenue), and U.S. appropriated funds ($140 million).

As of June 19, 2004, the local commanders have spent $364.6 million in CERP funds on over 27,600 small projects. These projects include repairing and refurbishing water and sewer lines, cleaning up highways by removing waste and debris, transporting water to remote villages, purchasing equipment for local police stations, upgrading schools and clinics, purchasing school supplies, removing ordnance from public spaces including schools, and refurbishing playgrounds, youth centers, libraries, other recreational facilities, and mosques.

The following table provides a summary of how local commanders have spent CERP resources through June 19, 2004:

<table>
<thead>
<tr>
<th>Project Type</th>
<th>Number of Projects</th>
<th>Amount Disbursed ($millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>4,946</td>
<td>62.4</td>
</tr>
<tr>
<td>Electricity</td>
<td>792</td>
<td>8.2</td>
</tr>
<tr>
<td>Health</td>
<td>1,610</td>
<td>23.2</td>
</tr>
<tr>
<td>Other Public Services</td>
<td>5,134</td>
<td>66.8</td>
</tr>
<tr>
<td>Police/Security</td>
<td>4,029</td>
<td>87.5</td>
</tr>
<tr>
<td>Reconstruction</td>
<td>2,814</td>
<td>34.7</td>
</tr>
<tr>
<td>Rule of Law/Government</td>
<td>1,431</td>
<td>15.9</td>
</tr>
<tr>
<td>Social Programs</td>
<td>752</td>
<td>6.6</td>
</tr>
<tr>
<td>Transportation</td>
<td>310</td>
<td>5.4</td>
</tr>
<tr>
<td>Water/Sewer</td>
<td>2,270</td>
<td>30.5</td>
</tr>
<tr>
<td>Other projects</td>
<td>3,534</td>
<td>23.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>27,622</strong></td>
<td><strong>364.6</strong></td>
</tr>
</tbody>
</table>

The Accelerated Iraqi Reconstruction Program: Building on the success of CERP, CPA established the Accelerated Iraq Reconstruction Program (AIRP), an effort to identify high economic impact projects in key cities (Baghdad, Baqubah, Fallujah, Mosul, Ramadi, Samarra, Tikrit, Najaf, Diwaniyah, and Karbala) that could be quickly implemented to improve the daily lives of the Iraqi people, by creating jobs and providing additional security. While similar to CERP activities, AIRP projects are focused on these cities and are somewhat larger than CERP projects in size. To fund this effort CPA, in conjunction with the Iraqi Ministry of Finance and the Ministry of Planning, allocated almost $300 million from the additional OFF revenue in the DFI for AIRP projects.
A team of representatives from the Program Management Office (PMO), military Major Subordinate Commanders (MSC), and Regional Governorates worked with the Iraqi Governors, city and provincial councils to identify priority reconstruction projects primarily geared towards generating employment. The majority of the large projects over $100,000 have been related to potable water, wastewater, solid waste disposal, health, education, and transportation. These include construction of 16 schools in Ramadi and Fallujah, improvements to sewers in Baghdad’s Al Rashid and Sadr City neighborhoods, a landfill in Baqubah, and road work in Mosul and other cities. However, a broad range of small-and medium-size (under $100,000) projects were also identified, including for example, veterinary clinics for livestock and farmers markets to promote trade.

While some of the large projects have been awarded to PMO design-build contractors, the majority of projects will be awarded directly to local Iraqi firms for the design and construction. More than 140 projects totaling more than $277 million are under contract and are employing over 7,700 Iraqis.

Plans for Unpaid DFI Commitments

CPA’s authority over the DFI has ended and the Iraqi Interim Government (IIG) has assumed legal authority. There are a number of DFI-funded CPA contracts (entered into by the CPA pursuant to the authorities and in accordance with the standards of UNSCR 1483) for goods and services. These contracts require performance and payment after June 28th but have not been secured by a letter of credit (which requires 100 percent funding in advance of receipt of goods and services). These contracts are vital to the reconstruction effort and must be honored. Therefore, CPA has developed procedures to mitigate the potential default risk that could occur as contracts transfer to the IIG. U.N. Security Council Resolution 1546 (2004) explicitly states that the DFI “shall be utilized to satisfy outstanding obligations against the Development Fund for Iraq.”

To ensure timely performance, contractors must be guaranteed payment without interruption. To this end, CPA has developed the following plan:

- First, any unobligated balances from the CERP, Local Governance Programs, and other programs funded by the DFI will be returned to the DFI account at the Central Bank of Iraq. This ensures that no new contracts using DFI can be entered into post June 28, 2004 for these programs.

- Second, on June 15, 2004 the Minister of Finance designated the Director of the Program Management Office (and its successor organization) with the responsibility to monitor, certify and/or make payments, and otherwise administer unsecured DFI-funded contracts or grants with an aggregate outstanding value not to exceed $800 million. As of June 28, the value of outstanding contractual payments exceeded the $800 million cap. To address this, the U.S. embassy is working with the IIG on a process to ensure that all suppliers and contractors are paid.
• Third, the Minister of Finance will transfer from time to time funds from the DFI into a Central Bank of Iraq Account to enable PMO and MNF-I personnel to make payments for ongoing contracts in the field (eg., for the AIRP and other regional programs).

This plan will enable the officials most familiar with DFI-funded contracts to ensure uninterrupted performance, pending the IIG’s decision as to whether the contracts should be terminated, amended, or continued. The designated PMO and MNF-I personnel will assist the relevant officials from the IIG if the IIG decides to terminate or amend any contract.

The Transition

On June 28 the United States opened the U.S. mission in Iraq under the leadership of Ambassador Negroponte. The transition to a U.S. mission was the result of months of planning between the Departments of State and Defense. Their task was to address security, finance, facility, and personnel transition issues. Six months of intensive planning and execution produced a coordinated plan for the transfer of CPA functions to the Interim Iraqi Government and U.S. Government agencies.

The embassy in Baghdad will be one of the three largest U.S. diplomatic and consular missions around the world. The State Department anticipates that the U.S. mission will have nearly 900 Americans under Chief of Mission authority, and approximately 550 Foreign Service Nationals (FSNs) for a total mission size of just less than 1,500. This includes two temporary organizations created by the President to support IRRF management and implementation, the Iraq Reconstruction Management Office (IRMO) and the Project and Contracting Office (PCO).

Beyond Baghdad, the Chief of Mission presence will include four regional offices in Mosul, Kirkuk, Hilla, and Basra, as well as provincial teams located with five military units across Iraq. By providing a secure location for personnel under Chief of Mission authority, presence at these sites will be critical to implementing the reconstruction effort, continued cooperation with the Interim Iraqi Government, and dialogue with local leaders.

The provision of U.S. assistance in Iraq will be under the general direction and continual supervision of Secretary Powell and Ambassador Negroponte, including both the IRMO and PCO temporary organizations.

The Iraq Reconstruction Management Office (IRMO)

The IRMO will assume policy oversight of the reconstruction effort, and will coordinate all other U.S. assistance activities in Iraq. More specifically, IRMO will:

• Develop and coordinate a strategic plan for U.S. assistance to Iraq, and ensure it remains consistent with overall U.S. foreign policy goals;
• Coordinate Country Team recommendations to the Chief of Mission concerning assistance priorities and requirements;
• Track IRRF spending and prepare reports for the Department of State, OMB, Congress, and other agencies as required;
• Provide technical advisors as requested by Iraqi ministries and other organizations such as the Commission on Public Integrity;
• Coordinate with the MNF-I commander or his designee to integrate aid to Iraqi Security Forces into the overall assistance effort; and,
• Support embassy public diplomacy efforts related to U.S. assistance to Iraqi reconstruction.

The Project and Contracting Office (PCO)

The Project and Contracting Office (PCO), formerly the CPA Program Management Office, will continue to provide acquisition and direct program management support with respect to certain construction, procurement, and other activities in Iraq. PCO will be administered by the Army, but will come under Chief of Mission authority. PCO will:

• Implement on-going IRRF projects and additional projects directed by the Chief of Mission;
• Provide “cross-cutting” management services as requested to ensure integration of projects within and across infrastructure sectors and within and across other sectors when requested by IRMO or other agencies;
• Coordinate procurement activities for Do D projects and as requested by other implementing agencies;
• Collect and report financial and program data as requested by IRMO; and
• Undertake such other reconstruction-related activities as the Chief of Mission, IRMO, or other agencies may request.

Other Implementing Agencies

Other agencies to which IRRF funds may be apportioned (USAID, Do D, State, HHS, and Treasury) will:

• Carry out projects throughout Iraq under the direction, coordination, and supervision of the Chief of Mission;
• Regularly report data on their progress to IRMO; and
• Cooperate with integration and coordination efforts of the IRMO as well as PCO on all construction, appropriate procurement, and other agreed projects to which PCO has been requested to provide management services.

Operational costs of the new U.S. mission

Opening the embassy is an essential step toward conducting business directly with the newly formed Iraqi government on a broad range of bilateral and multilateral issues. The current estimate for the U.S. embassy costs for FY 2004 and FY 2005 is approximately $1.5 billion.

For the fourth quarter of FY 2004, the costs to stand up and operate the embassy and continue necessary functions of the CPA will be in the range of $480 million. This includes funds to support readying temporary facilities and housing, providing additional information technology
infrastructure, administrative and personnel support costs, and to establish regional State Department teams and a temporary Iraq Reconstruction Management Office (IRMO). These costs will be covered through existing funds, including CPA’s fourth quarter operating budget ($196 million) available to fund the successor to CPA, the one percent transfer of Iraq Relief and Reconstruction Funds ($184 million) available under law, and from funds directly appropriated to the Department of State for these purposes in FY 2003 and FY 2004 supplemental appropriations ($97.3 million).

For FY 2005, the estimated operating cost is approximately $1 billion, which is exclusive of capital facility costs for a new embassy compound (NEC) and the Project and Contracting Office (PCO). The largest cost components of running the U.S. mission in FY 2005 are logistics and security. The Department of Defense will continue to sustain current support available under the Logistics Civilian Augmentation Program (LOGCAP) and security support for the new U.S. mission until the Ambassador’s team has time to assess the actual needs and provide a cost estimate for support that can be included as part of a 2005 supplemental request.

With respect to the new permanent embassy, the State Department has begun the planning process for a new compound in Baghdad. In the interim, the State Department has identified a building in the Green Zone to serve as the temporary Chancery until a more permanent facility can be established. The State Department is also readying two additional facilities (an embassy annex and the ambassador's residence) in the Green Zone with funds previously appropriated for that purpose.

The temporary Chancery will serve as the office of the ambassador and a limited number of staff. Until the NEC is constructed, the State Department will also continue to use the space inhabited by CPA for most non-public operations, and will continue to use the residence of former CPA Administrator Bremer.

The State Department has identified a site for a new American embassy facility. The proposed compound would include offices, housing, and support facilities for U.S. and locally engaged staff. The Department continues to work to develop requirements, such as determining the appropriate number of staff for the facility, so that when State Department does present a final cost estimate, it is based on the right size for U.S. foreign policy goals in Iraq.

Facility costs extend beyond Baghdad. Setting up the regional sites will not require significant new investments due to the availability of former CPA assets and the assistance of U.S. military forces. However, their continued operation in relatively vulnerable areas will require security and logistical support. CPA and DOD funds can address these requirements through the middle of FY 2005, but these costs will need to be incorporated into the overall Chief of Mission budget.

The Report

Appendix I of this report provides by sector and by project: a discussion of changes from the April report, developments to date and those anticipated in the next quarter. Appendix 2 of the report provides more information on international contributions to Iraq reconstruction.