



Development Fund for Iraq

IAMB & COFE Meeting – May 12-13, 2008

Summary Audit Results December 31, 2007

Content

- ▶ Scope of work and deliverables
- ▶ Entities covered
- ▶ Financial statement
- ▶ Outstanding data
- ▶ Key issues
- ▶ Internal control material weaknesses
- ▶ Crude oil usage – high level analysis

Our presentation is intended solely for the information and use of the IAMB, COFE and Iraqi Ministry of Finance and is not intended to be and should not be used by anyone other than these specified parties. Ernst & Young therefore assumes no responsibility to any user of the report other than these parties. Any other parties who choose to rely on our report do so entirely at their own risk.

This presentation contains a summary of the key findings only. The full findings of our audit are contained in separate reports provided to the IAMB and COFE.

Scope of Work and Deliverables

Scope of work	Deliverables	Reporting Date
Interim Review <ul style="list-style-type: none"> Review Interim Financial Statement as of June 30, 2007 Oil Production Quantity Reconciliation (Additional Request) 	<ul style="list-style-type: none"> Review Report on DFI Interim Financial Statement Results of Review Procedures, Key Findings and Recommendations Presentation to the COFE and IAMB 	October, 2007
Final Review <ul style="list-style-type: none"> Audit DFI Financial Statement Audit the Disbursements of US Agencies Funds Disbursed by all Spending entities Testing Oil Proceeds Receipt Account (OPRA) 	<ul style="list-style-type: none"> Audit report on DFI Financial Statement including Oil Export Sales, Oil Proceeds Receipts Account (OPRA) Management Letter Report on Internal Controls related to Financial Statement data collection and preparation Management Letter Report on Internal Controls related to spending Entities Report on Oil Production and Consumption – High Level Analysis Presentation to the COFE and IAMB 	April, 2008

Entities covered

- ▶ Ministry of Finance (MoF)
- ▶ Central Bank of Iraq (CBI)
- ▶ Ministry of Oil (MO)
- ▶ Oil Marketing Company (SOMO)
- ▶ Iraqi Ministries in Baghdad
- ▶ Iraqi Ministries in Sulaimanya & Erbil
- ▶ US agencies

Financial statement

Statement of cash receipts and payments

Description	January 1 to December 31,2007 U.S. \$ Million	January 1 to December 31,2006 U.S. \$ Million	From inception to December 31, 2007 U.S. \$ Million
Cash Receipts			
Crude Oil Exports	35,883	28,311	106,325
UN Oil for Food Program	186	185	10,411
Proceeds from Frozen Assets	5	17	1,552
Interest Received	561	453	1,327
Other Receipts	883	589	2,065
<u>Total Cash Receipts</u>	<u>37,518</u>	<u>29,555</u>	<u>121,680</u>

Financial statement

Statement of cash receipts and payments (Cont'd)

Description	January 1 to December 31, 2007 U.S. \$ Million	January 1 to December 31, 2006 U.S. \$ Million	From inception to December 31, 2007 U.S. \$ Million
Cash Payments			
Transfers to MoF	26,700	18,000	74,079
LC's to the Benefit of Iraqi entities	7,559	9,889	28,169
Contracts Administered by US Agencies	116	251	7,541
Iraqi External Debt Repayments	142	539	1,285
Other Payments	151	103	700
Total Cash Payments	34,668	28,782	111,774
Excess of Receipts Over Payments	2,850	773	9,906
Purchased Treasury Bills During the Period	(14,516)	(9,910)	(26,394)
Proceeds From Treasury bills on maturity During the Period	12,746	6,289	19,035
Cash and Cash Equivalent, Beginning of the Period	1,467	4,315	-
Net Cash Available For Use	2,547	1,467	2,547
Treasury Bills, End of Period	7,359	5,589	7,359
Cash, and Cash Equivalents and Treasury Bills, End of Period	9,906	7,056	9,906

Outstanding data

- ▶ Detailed schedule related to contracts administrated by U.S. agencies during the year.

Key issues

- ▶ DFI accounting records are maintained by MoF as part of its records and DFI is not recognized as a separate reporting entity. In addition MoF does not maintain a separate bank account for DFI at CBI.
- ▶ MoF records does not include a complete set of accounting records to support DFI's financial statement figures and related notes disclosures. Accordingly data obtained may not be tested for completeness.
- ▶ DFI's statement of cash receipts and disbursements was compiled from the following records which has not been officially reconciled :
 - ▶ Monthly statements of DFI's main account prepared by CBI,
 - ▶ DFI's sub-account maintained by US Agencies and CBI,
 - ▶ FRBNY statements,
 - ▶ MoF manual records and Access Database.
- ▶ During 2007, the MoF has established a designated database for DFI to collect all transactions and accounting records in.

Key issues (Cont'd)

- ▶ A substantial part of the DFI receipts is from the export sales of petroleum. The IAMB recommended in March 2004 the expeditious installation of a comprehensive oil metering system in Iraq and in accordance with standard oil industry practices, While the Iraqi Government supports oil metering, progress has been slow. Some metering has been installed at oil terminals, but there continues to be no metering in the oil fields. Because of the absence of an overall comprehensive system of controls over oil, there are un-reconciled differences between oil extraction, production, export sales and internal usage.
- ▶ Cash received from export sales of petroleum products of U.S. \$ 770 million for this year is deposited in SOMO's bank accounts instead of OPRA as required by UNSCR 1483.

Key issues (Cont'd)

- ▶ SOMO was engaged in barter transactions with the Syrian Government valued at U.S. \$ 217 million in exchange for electricity and petroleum products. These transactions are not reported in DFI records. Cumulatively barter transactions since inception amounts to U.S. \$ 1,033 million.
- ▶ MoF paid an amount of US\$ 891 million from DFI accounts for LCs related to self financing entities that are paid back to MoF by the entities. Moreover, MoF has received advances of U.S. \$ 1,170 million from these entities to cover their LCs. This amount has not been deposited in DFI accounts; it was deposited in MoF account. As a result, DFI cash payments balance during the year is overstated and the cash balance as of 31 December 2007 by U.S. \$ 891 million.

Key issues (Cont'd)

- ▶ Total cash transfers from DFI to MoF account for this year amounting to U.S. \$ 26,700 million has been recorded as cash payments in DFI financial statement before the amounts were transferred to the entities. Moreover the total amount transferred to the entities during this year by MoF is U.S. \$ 30,518 million, (Exceeds MoF receipts by U.S. \$ 3,818 million).
- ▶ The accumulated excess of funds transferred to MoF over amounts transferred to entities is U.S. \$ 2,219 million as of 31 December 2007.

Key issues (Cont'd)

- ▶ According to UNSCR 1483 (2003), 5% of the proceeds of export sales of oil and oil products shall be deposited into United Nations' Compensation Fund, however MoF has no information on the following:
 - ▶ The balance available at the Compensation Fund.
 - ▶ The remaining outstanding amounts due to United Nations Compensation Fund.
 - ▶ The estimated date of the final payment to Compensation Fund.
- ❖ **Following the meeting with IAMB and COFE, we received a letter from the United Nations providing us with the following information:**
- ❖ **Balance available at the Compensation fund : U.S.\$ 0.36 billion.**
- ❖ **The remaining outstanding amounts due to United Nations Compensation Fund : U.S.\$ 28.95 billion.**
- ❖ **As of December 31, 2007 about U.S. \$ 23.43 billion had been paid out to award recipients.**
- ❖ **At the present rate of Iraqi oil sales, it would take approximately 17 years for the compensation award to be fully paid.**

Internal control material weaknesses

Cash margins at corresponding banks

- ▶ CBI and MoF do not maintain any records of the outstanding entities' cash margins against LCs. There is a large number of long outstanding cash margin balances with TBI's corresponding bank for LCs that were opened through TBI for the benefit of entities'.

Internal control material weaknesses (Cont'd)

CBI Transfers to MoF's Current IQD Account

- ▶ There is currently no written agreement between MoF and CBI as to the arrangements to be followed to finance MoF's Iraqi Dinar current account at CBI from DFI FRBNY account.
- ▶ CBI is financing MoF's current account by withdrawing the amount from DFI account at FRBNY in U.S. Dollar and then transferring an equivalent amount in Iraqi Dinar to MoF's current account at CBI.
- ▶ The exchange rate used is CBI's formal exchange rate plus a commission of IQD 15 for each US Dollar.

Internal control material weaknesses (Cont'd)

US agencies contracts

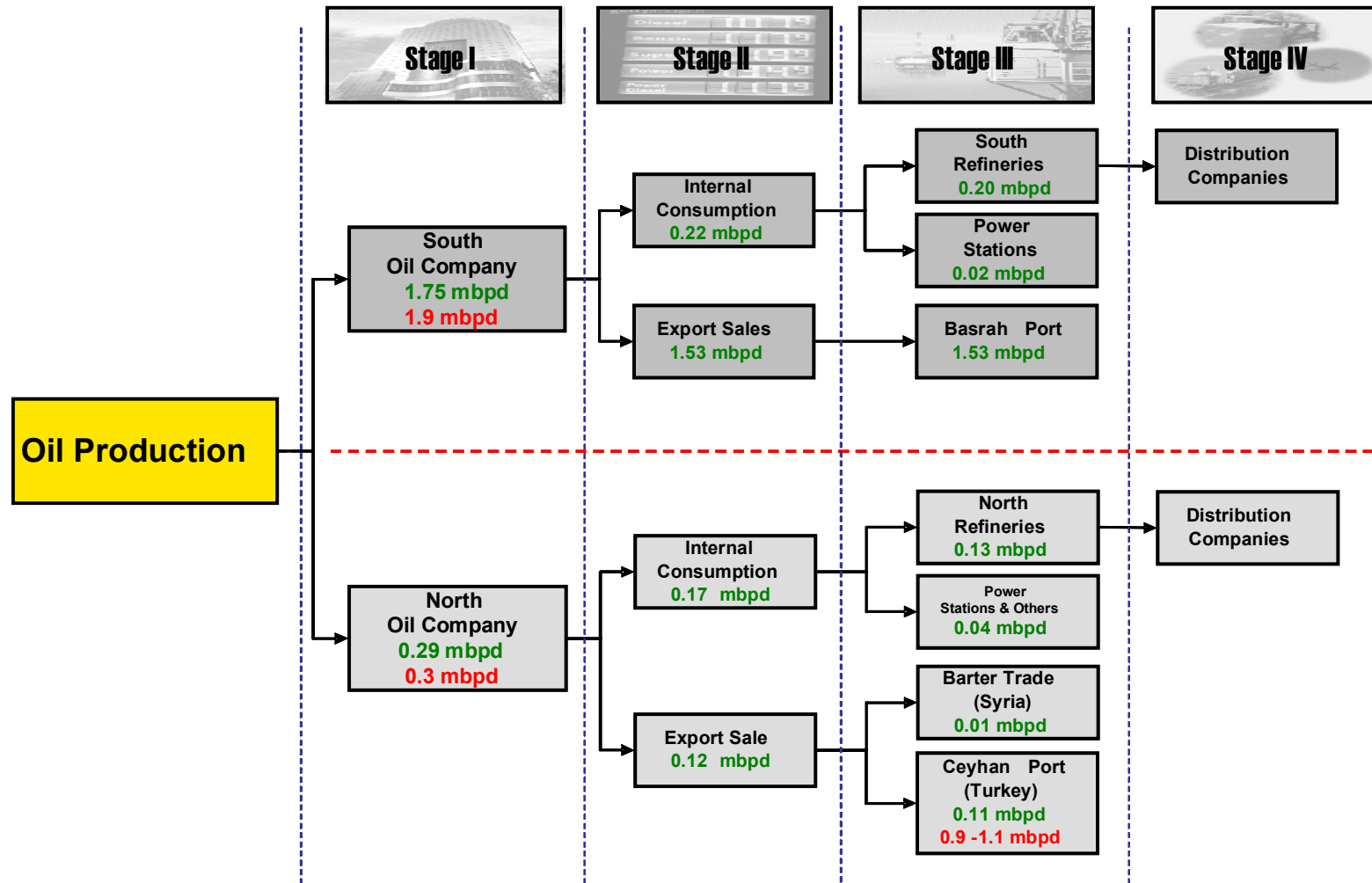
- ▶ US Agencies does not maintain a complete set of DFI accounting records, they maintain two separate Excel databases for each of payment transactions and contracts. However, these databases are not integrated.

Internal control material weaknesses (Cont'd)

Reconciliation between MoF and Other governmental entities

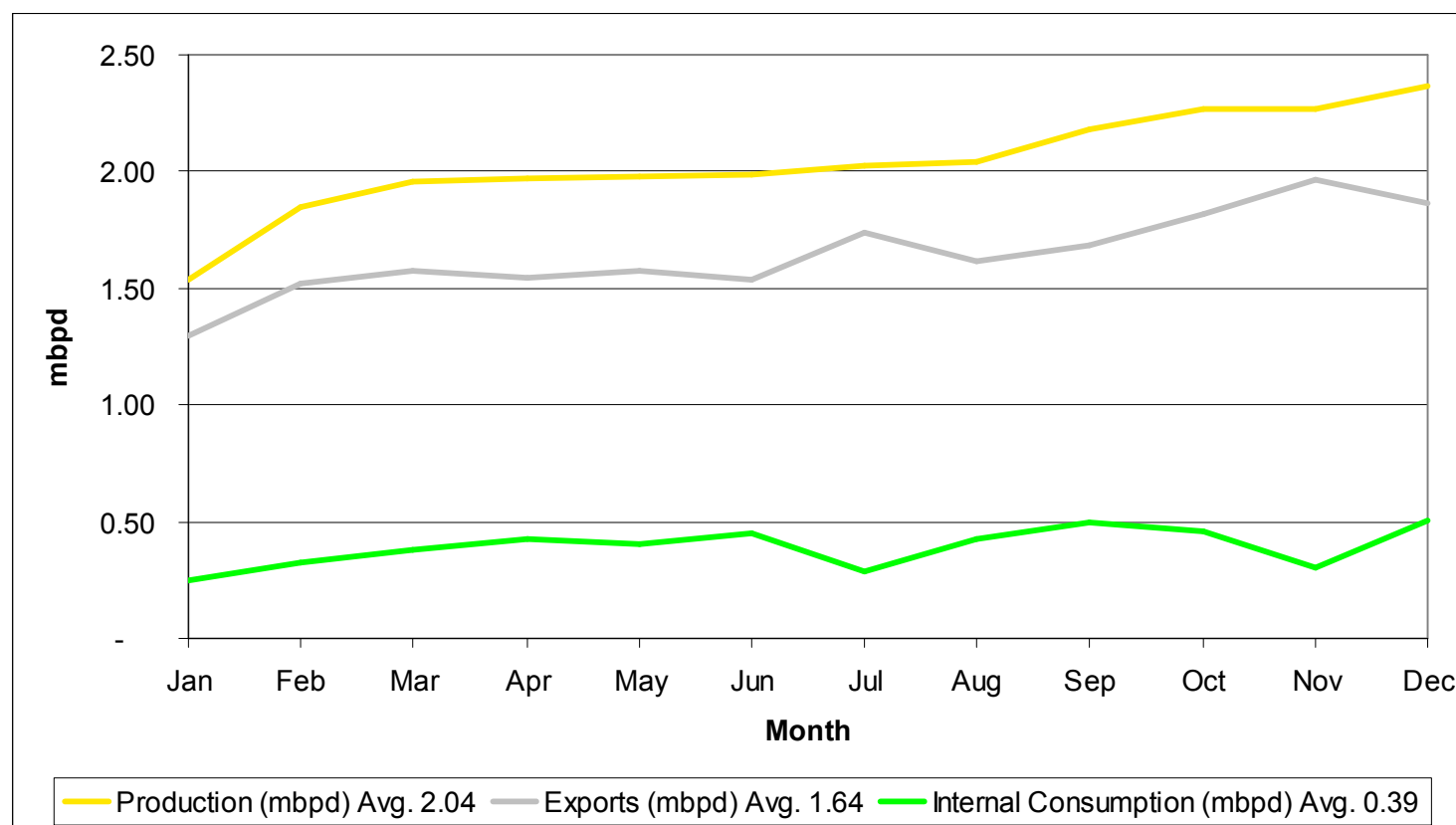
- ▶ Differences between amounts transferred to entities and amounts recorded in MoF records as transfers have been noticed.
- ▶ MoF does not carry out monthly reconciliations of the payments transferred from the DFI to the ministries and government entities between the MoF records and the records of the other ministries and government entities records.
- ▶ Due to the absence of formal reconciliations, these differences can not be reliably justified. However, timing differences and/or currency exchange rates differences were major reasons Iraqi governmental entities justified these differences by.

Crude oil usage – high level analysis



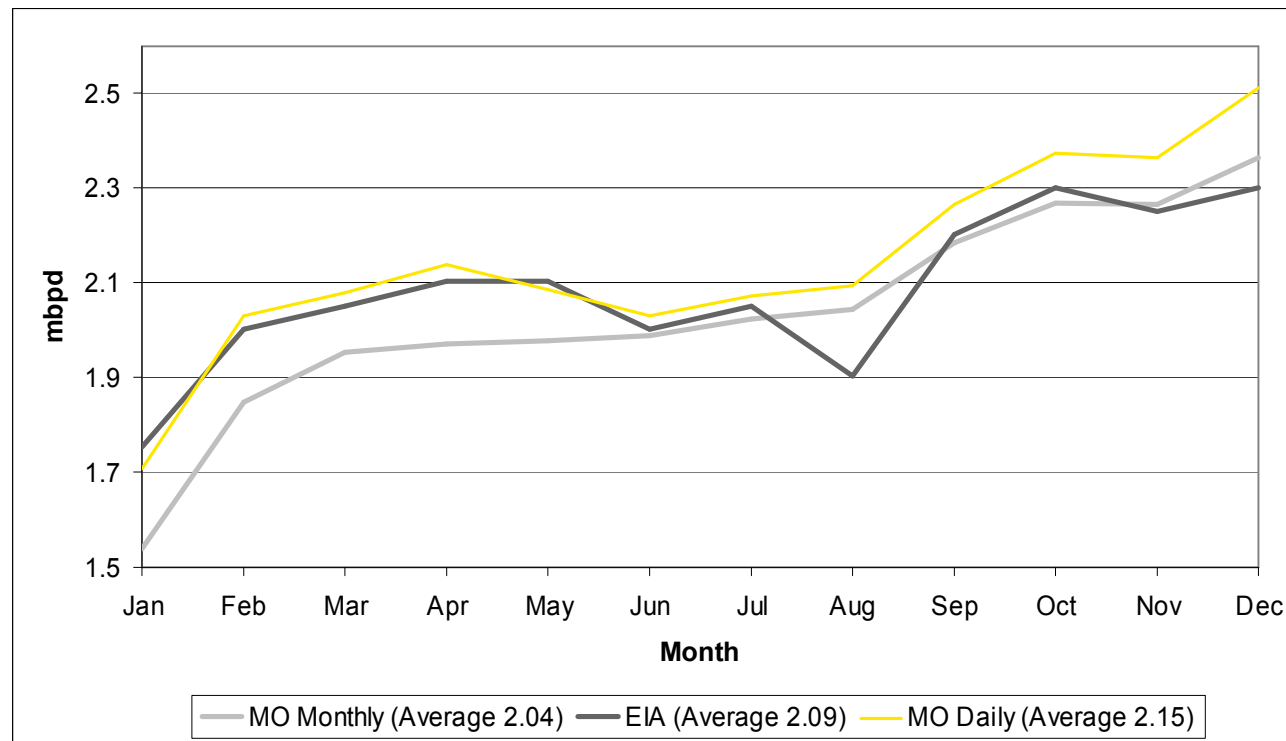
Crude oil usage–high level analysis (Cont'd)

This diagram represents crude oil production, exports and internal consumption extracted from data provided to EY.



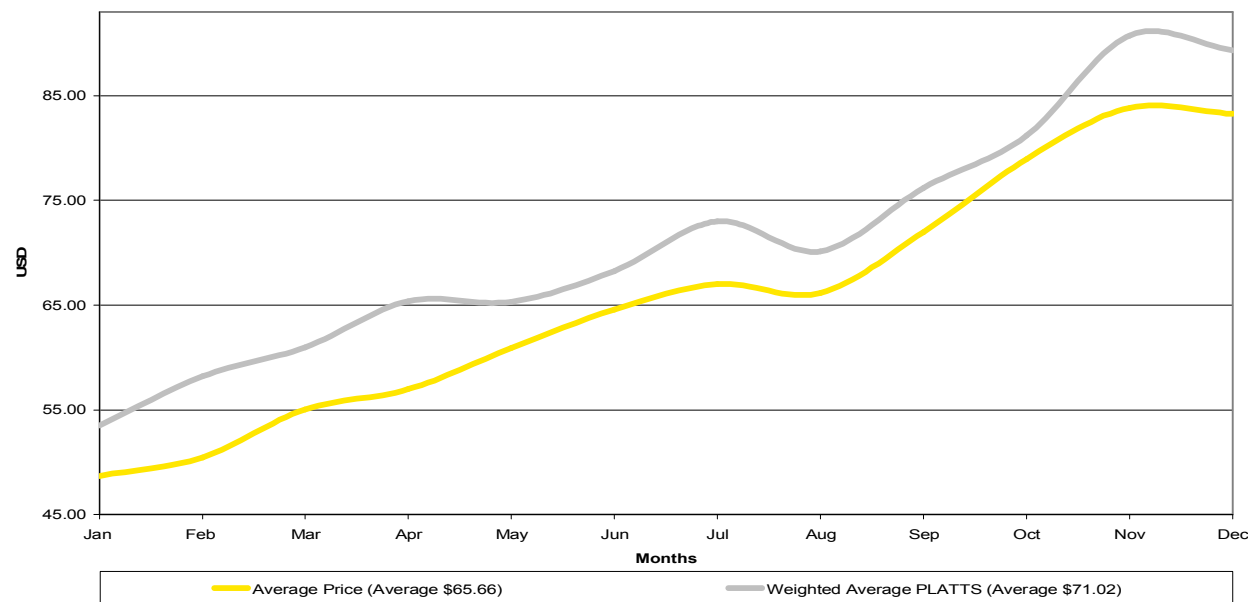
Crude oil usage–high level analysis (Cont'd)

This diagram represents a comparison between crude oil production data as provided by EIA, and data provided to EY from January to December 2007 (mbpd)



Crude oil usage–high level analysis (Cont'd)

This diagram represents a comparison between Iraqi Actual Oil Price and Weighted Average Quoted international Oil price During 2007.



Actual price is different from PLATTS price mainly due to API, Price Differential and freight

Crude oil usage–high level analysis (Cont'd)

Quantities for the year ended December 31, 2006

Category	Ministry of Oil Data	North & South Oil Companies' Data	Export and Internal Consumption (SOMO, Power Station & Refineries Reports)	Petroleum Products By Refineries
	Barrel 000'	Barrel 000'	Barrel 000'	Barrel 000'
Crude Oil Produced	713,594	713,595	-	-
Crude Oil Exports	550,986	550,986	549,395	-
Available for Internal Consumption	162,608	162,609	-	-
Quantities Received by refineries	126,990	124,304	126,335	124,188
Quantities Received by Power stations	16,498	14,614	16,486	-
Internal Consumption	143,488	138,918	142,821	-
Net Crude Oil After Export & Internal Consumption	19,120	23,691	-	-

Crude oil - high level analysis

Quantities for the period from January 1, 2007 to December 31, 2007
(Table 1)

Description / Source of Data	Ministry of Oil	North & South Oil Companies'	Export and Internal Consumption (SOMO, Power Station & Refineries Reports)	Petroleum Products By Refineries
	Barrel 000'	Barrel 000'	Barrel 000'	Barrel 000'
Crude Oil Produced	742,890	742,890	-	-
Crude Oil Exports	599,642	599,642	599,642	-
Available for Internal Consumption	143,248	143,248	-	-
Quantities Received / Produced by Refineries	120,957	120,957	121,005	111,693
Refineries' Waste Blended with Exported Oil	(9,579)	(9,579)	-	-
Quantities Received by Power Stations	17,988	17,988	21,023	-
Internal Consumption	129,366	129,366	142,028	-
Net Crude Oil After Export & Internal Consumption	13,882	13,882	-	-

Oil products – high level analysis

Oil products quantities for the period from January 1, 2007 to December 31, 2007 (Table 2)

Category Description / Source of Data	Refineries'	Pipelines'	Distribution Company	Power Stations'	SOMO's	Difference
	Barrel 000'	Barrel 000'	Barrel 000'	Barrel 000'	Barrel 000'	Barrel 000'
Refined Products Received by Pipelines Company/ Sent By Refineries	(34,358)	46,079	-	-	-	11,721
Refined Products Received by Distribution Company / Sent By Refineries	(44,988)	-	41,816	-	-	(3,172)
Refined Products Received by Power Generating Companies / Sent By Pipelines Company	-	(12,987)	-	15,572	-	2,585
Fuel Oil Exports Quantities Reported By SOMO / Sent By Pipelines Company	-	(9,964)	-	-	15,804	5,840
Refined Products Sent by Pipeline Company/ Received By Distribution Company	-	(41,793)	42,537	-	-	744
Net Total	(79,346)	(18,665)	84,353	15,572	15,804	17,718

Oil production & consumption

Significant findings & limitations to reconciliation of oil

- ▶ Other than export sales, most of the parties involved in the oil industry in Iraq depend on the “Reverse Measurement Method” in recording the quantities of oil and oil products. (i.e. no metering system is in place). Additionally, some of the refineries have reported that even when they have metering systems, these metering systems are not utilized because they require calibration or repair.
- ▶ The report provided by MO in relation to oil production and consumption does not add up. The net crude oil after export & internal consumption quantity of 13,882 thousand barrel (table 1) cannot be allocated accurately to specific uses. The following quantities were reported by MO in relation to the aforementioned quantity:
 - ▶ Injection to wells: 12,102 thousand barrel
 - ▶ Change in inventory : (411) thousand barrel
 - ▶ Other Usages : 2,687 thousand barrel
- ▶ We have noticed significant differences in relation to oil products movements between Refineries, Pipelines, Distribution, and Power Stations (table 2).

Oil production & consumption

Significant findings & limitations to reconciliation of oil (Cont'd)

- ▶ Refineries' Data (table 1) indicates that 111,693 thousand barrel of oil products is produced, while refineries as per table (2) also reported that only 79,346 thousand barrels were sent for internal usage. In addition to that the quantity received by Distribution Company was 84,353 thousand barrel. This difference cannot be explained only by changes in Inventory at the beginning and end of the year.
- ▶ The previous tables show discrepancies in oil data between different official sources. In addition, the actual usage of crude oil destined for domestic consumption is not clearly understood.
- ▶ Reports provided by different entities are not standardised. Accordingly some information needed for the reconciliation is not available or partially available (i.e. Injection, storage, pipeline waste information).

Oil production & consumption

Significant findings & limitations to reconciliation of oil (Cont'd)

- ▶ Due to lack of a comprehensive metering system, crude oil production cannot be reliably measured.
- ▶ There should be a technical reconciliation between crude oil delivered to refineries and their output.
- ▶ We have noticed that no reconciliation is being officially prepared in order to control the quantities of oil blended with exports and/or injected to wells.
- ▶ Oil Reconciliation is not officially prepared and checked by an independent party.
- ▶ Oil Industry benchmarks indicate that the normal output of Oil refining process is between 102% to 105% of the crude oil refined, however, Iraqi refineries have operated only at 92% (table 1).
- ▶ The Government's priority in this regard should therefore be to properly designing, installing, operating and maintaining measurement equipment sufficient to accurately determine produced, transported, refined, imported, consumed, and sold products at all points along Iraq's oil product related networks.



Q&A

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