Statement by the International Advisory and Monitoring Board on Iraq—Release of the KPMG Audit Reports on the Development Fund for Iraq

July 15, 2004

The International Advisory and Monitoring Board (IAMB) on Iraq has been presented with the first reports by KPMG covering audits of the oil export sales and the Development Fund for Iraq (DFI) operations through end-December 2003, which had, following the IAMB's approval, been commissioned by the Coalition Provisional Authority (CPA) in March 2004. The audit reports are being published on the IAMB website (www.iamb.info). The purpose of this statement is to provide context for the audit reports and background to the work of the IAMB.

Background

The IAMB commenced operations in December 2003 as an audit oversight body for the Development Fund for Iraq (DFI). Pursuant to United Nations Security Council resolution 1483 (http://www.iamb.info/pdf/unsc1483.pdf), the DFI receives the proceeds of oil export sales from Iraq, balances from the UN Oil-for-Food Program and frozen Iraqi funds. Until June 28, 2004 disbursements from the DFI were to be directed by the CPA in consultation with the Iraqi interim administration for purposes specified in that resolution. The mandate and membership of the IAMB has been extended by United Nations Security Council resolution 1546 (http://www.iamb.info/pdf/unsc1546.pdf) and resources in the DFI are now controlled by the Interim Government of Iraq. The IAMB's terms of reference adopted in October 2003 are available at http://www.iamb.info/tor.htm . The IAMB functions akin to an audit committee in accordance with international best practices.

The IAMB initially comprised four members representing the Executive Heads of the Arab Fund for Economic and Social Development, the International Monetary Fund, the United Nations, and the World Bank (http://www.iamb.info/members.htm). A fifth member has recently been designated by the Interim Government of Iraq. So far the IAMB has approved the appointment of three observers; two representing the Iraqi authorities and one representing the CPA. The IAMB has also invited the Iraq Board of Supreme Audit to participate in its work.

Under its mandate, the IAMB oversees audits conducted by international accounting firms of (i) oil export sales to ensure that such sales are consistent with prevailing international market best practices, (ii) the accounting for the proceeds from oil export sales, (iii) the DFI financial statements, and (iv) the disbursement procedures for DFI resources to ensure that funds are used for the purposes intended. Decisions on the use of DFI funds were, until June 28, 2004 taken by the CPA, in conjunction with the Program Review Board. Spending allocations are now made by the Interim Government of Iraq.

After an international competitive bidding process, in March 2004 the IAMB approved the CPA's appointment of KPMG to conduct audits in two stages: first, for DFI activities through December 2003, which are the reports made available today, and second for the six month period ended June 2004, which is currently under way.

IAMB Concerns Over the Control and Use of Iraqi Oil Assets

The IAMB has previously announced its concern about inadequate controls over Iraqi oil and other aspects of the DFI's operations (http://www.iamb.info/pressrel.htm). In particular, the IAMB has repeatedly raised the following issues with the CPA:

- **The absence of oil metering**. The IAMB recommended in March 2004 the expeditious installation of metering equipment in accordance with standard oil industry practices. Contrary to earlier representations by the CPA, the award of metering contracts has been delayed and it is therefore impossible to ascertain that all oil extraction is properly accounted for.
- **The use of barter transactions for certain oil sales**. The IAMB has been concerned that barter transactions are not reflected in the DFI as required by UNSCR 1483. The IAMB understands that some bartering of oil for electricity with a neighboring country continues. The use of barter transactions makes it difficult to determine whether fair value has been received for Iraq's oil revenues.
- **The use of non-competitive bidding procedures for some contracts funded from the DFI**. DFI funds were used to award contracts on a non-competitive basis. To ascertain the conditions and circumstances, the IAMB has requested copies of reports on audits of sole-sourced contracts that have already been undertaken by various US agencies, before determining whether additional audits are necessary. Despite repeated requests, these reports have still to be made available to the IAMB.
- **The results of a review of controls in the State Oil Marketing Organization (SOMO).** The CPA commissioned a review of controls in SOMO by KPMG in February 2004. The review was substantially complete in May 2004, but the IAMB has neither been briefed nor received the draft report, despite requests to the CPA.

In light of these concerns, the IAMB directed KPMG to pay special attention to the treatment of barter transactions in the DFI financial statements, to sole-sourced contracting procedures, and to controls over oil transactions.

The KPMG Reports

The KPMG reports speak for themselves and stand on their own and are in line with earlier IAMB observations. KPMG has concluded that all known oil proceeds, reported frozen assets, and transfers from the Oil for Food Program have been properly and transparently accounted for in the DFI. At the same time, based on a review of the KPMG reports, the IAMB believes that controls were insufficient to provide reasonable assurance (i) for the completeness of export sales of petroleum and petroleum products for the period from May 22, 2003 to December 31, 2003, and (ii) whether all DFI disbursements were made for the purposes intended.

The main findings are as follows:

- Weaknesses in controls over oil extraction, including the absence of metering, resulted in KPMG qualifying its audit opinion of the DFI's statement of cash receipts and payments. The CPA believes that unknown quantities of petroleum and petroleum products were illegally exported from Iraq (smuggling), especially in the early months post-hostilities, by-passing the authorized processes of marketing, sales and cash collection.
- Control weaknesses identified at the CPA include: (i) lack of clearly defined roles and responsibilities and high turnover of CPA personnel, (ii) inadequate accounting systems, (iii) the non-adherence in a number of instances to the Program Review Board's controls over spending allocations, and (iv) the uneven application of agreed-upon contracting procedures, including inadequate record keeping.
- Inadequate controls identified at Iraqi spending ministries examined to date by KPMG include (i) the absence of reconciliation procedures for transfers between ministries and for bank accounts, (ii) inadequate accounting records, (iii) deviations from the tendering procedures designed to ensure competitive bidding, (iv) and insufficient payroll records.

Next Steps

Over the next few weeks, the IAMB will consider whether further special audits or investigations are necessary. In the meantime, the IAMB will follow-up on its earlier decision for a special audit of the sole-sourced contracts that utilized DFI funds. The results of the second stage of KPMG's work will also have a bearing on any further recommended steps.

The IAMB hopes that the Government of Iraq will give priority to (i) the installation of oil metering, (ii) the establishment of adequate financial controls over the use of resources within Iraqi spending ministries, including securing the integrity of the payroll process, which is a significant proportion of government expenditure, (iii) the implementation and follow up of KPMG's recommendations to SOMO, and (iv) the implementation of a strong budgetary and financial management framework.

The IAMB acknowledges that KPMG and the CPA have operated under challenging circumstances. The IAMB looks forward to continued collaboration with the Interim Government of Iraq, the Iraq Reconstruction Management Office, and KPMG.