Development Fund for Iraq

Management Report
on Internal Controls

For the period from 1 January 2005 to 30 June 2005

KPMG Iraq
29 September 2005
This report contains 11 pages
To the Government of Iraq  
To the International Advisory and Monitoring Board of the  
Development Fund for Iraq  

29 September 2005  

Dear Sirs,  

We have audited the Statement of Cash Receipts and Payments of the Development Fund for Iraq (DFI or the Fund) for the period from 1 January 2005 to 30 June 2005, and have issued our report thereon dated 29 September 2005. In planning and performing our audit of the financial statement of the Fund, we considered internal controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statement. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

We have also performed agreed-upon procedures on the Fund’s Export Sales, Oil Proceeds Receipts Account and Disbursements for the period from 1 January 2005 to 30 June 2005, and have issued our reports of factual findings in connection with these procedures dated 29 September 2005.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate officials at the Iraqi Ministries and US Agencies, are intended to improve internal control or result in other operating efficiencies. Certain minor items involving internal control are not included in this management report; minor items were discussed with appropriate officials as considered necessary.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statement and therefore may not bring to light all weaknesses in policies or procedures that may exist and should not be relied upon to disclose errors or irregularities, which are not material to the financial statement. We aim, however, to use our knowledge of the Fund gained during our audit work to make comments and suggestions that we hope will be useful to you.

We thank the officials of the Government of Iraq and their Ministries, the KRG Administration and the US Agencies in Baghdad for their time and efforts during our procedures as we appreciate the unique challenges of working in Iraq.
This report is intended solely for the information and use of the Government of Iraq, and the International Advisory and Monitoring Board of the Development Fund for Iraq, and is not intended to be, and should not be, used by, or relied upon by, anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited. We do not accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our consent in writing.

Yours sincerely,

Michel Picard
Managing Partner
KPMG Iraq
1 Overall control environment

Following the dissolution of the Coalition Provisional Authority (CPA) on 28 June 2004, responsibility for the Development Fund for Iraq (DFI or the Fund) was transferred to the Government of Iraq. This responsibility includes complying with United Nations Security Council Resolution (UNSCR) 1546 and the maintenance of accounting records for the Fund.

1.1 Accounting records of the DFI

During February 2005, the MoF established a DFI department (Cash Management Department), to work alongside the Accounting Department at the MoF, to maintain the accounting records for the DFI. We found that accounting records for the DFI transactions for the period from 1 January 2005 to 30 June 2005 contained inaccuracies.

The MoF relies on information provided by the Central Bank of Iraq (CBI), including hand-written monthly reports, detailing transactions of the DFI account at the Federal Reserve Bank of New York (FRBNY). As this documentation does not include bank statements from the FRBNY, inaccuracies in the reports, as found by us, were replicated in the MoF’s accounting records.

The MoF should be provided with FRBNY bank statements, enabling the MoF to reconcile the DFI accounting records to bank statements. We also recommend that the CBI and the MoF have periodic meetings to reconcile their accounting records and discuss DFI related matters.

1.2 MoF funding from the CBI on behalf of the DFI

We found that the CBI funded the MoF from its own treasury and was subsequently reimbursed by the DFI. We also found that reimbursing payments made from the DFI to the CBI have not been reconciled against funding made by the CBI on behalf of the DFI.

Additionally, we found that the CBI funded $450,000,000 of fuel imports into Iraq from its own treasury rather than directly from the DFI, as was requested by the MoF. As a result of the alternative source of funding, the fuel import transaction was not recorded in the DFI accounting records.

A monthly reconciliation should be prepared between the amounts funded by the CBI and amounts reimbursed to the CBI by the DFI.

1.3 Investment of DFI funds

DFI funds at the FRBNY were invested in overnight deposits. The interest earned on overnight deposits ranged from 1.59% to 3.11% during the period to 30 June 2005.

The MoF should consider other low-risk investments, in consultation with the FRBNY or other financial advisors, in order to optimize returns on DFI funds.
2 The Iraqi Ministries

During our work at the MoF and other Iraqi Ministries visited (Oil, Trade, Electricity, Construction & Housing and the Kurdish Regional Government (KRG)), we noted the following matters:

2.1 Bank reconciliations

We found cases where bank reconciliations were not prepared, incorrectly prepared or not approved. We also found that certain transactions were not recorded in the accounting records. Furthermore, we found that timely follow-up of reconciling items was not performed.

We continue to recommend that bank reconciliations be performed for all bank accounts on a monthly basis and be approved by an independent person. Additionally, we recommend that the Internal Audit Department and / or the Board of Supreme Audit review the monthly bank reconciliations and report on their findings.
3 Contracting at the Iraqi Ministries

During our work at the Iraqi Ministries visited, we noted the following matters:

3.1 Contracting procedures

We found that contracting procedures were not consistently followed by the Iraqi Ministries, public tenders were not always performed and sole-sourced contracts did not contain sufficient written justification. We also found one contract in excess of $3,000,000 which was not approved by the Executive Ministers’ Committee.

In accordance with Iraqi Contracting Regulations, Ministries should ensure that there is a public tender, with at least three bids being obtained, to ensure optimum value is obtained for the products or services. In rare cases where contracts are to be awarded on a non-competitive basis, Ministries should document details of the justification for award on a sole-source basis and the procedures performed to determine price reasonableness and to obtain competition. Furthermore, justification should be authorized at an appropriate level.

3.2 Payment for participation in contract tenders

We found cases where suppliers were required to pay non-refundable amounts of up to $20,000 to participate in tenders. This may reduce the number of suppliers participating in a tender.

The requirement for suppliers to pay for submitting a proposal or obtaining tender documents should cease. Removal of tender fees should result in an increased number of bidders, greater cost efficiency and transparency for the Iraqi Ministries.

3.3 Segregation of duties

We found inadequate segregation of duties at a division of the Ministry of Oil, with Opening Committees, responsible for opening tendering documents, and also acting as Technical Committees, responsible for assessing technical merits of bids received.

The absence of an independent tender Opening Committee reduces the transparency and accountability of the contract award process. Ministries should ensure that each committee is independent and that individuals are not appointed to more than one committee.
3.4 Performance by suppliers

We found numerous cases where goods were not shipped in accordance with the contract and contracts were cancelled due to non-performance, resulting in significant delays to the delivery of goods or the performance of services.

We also found numerous cases where contracts were awarded on a lowest-cost basis without background checks being performed on the financial and operational capability of suppliers. Consequently, certain contracts were non-performing resulting in significant losses to the Ministries in the form of goods or services not being received and additional administrative costs to Ministries.

Background checks should be performed on all suppliers, including a review of past-performance, experience and also a credit check for international companies. Furthermore, a “blacklist” of all non-performing suppliers should be distributed to all Ministries, enabling each ministry to avoid non-performing suppliers.

We found that Letters of Guarantee (LG), required by Iraqi contracting regulations for governmental entities to ensure contract performance by suppliers, were not always obtained, or only obtained after Letters of Credit (LCs) were issued to contractors. LGs (typically 5% - 10% of the contract value) are required to encourage the contractor to deliver goods or services in accordance with their contractual obligations and in the event of non-performance, to cover administration costs for the tender process. Ministries should ensure that LGs are obtained for all contracts and that LCs are not opened until Ministries obtain LGs.

Additionally, we found that contractual penalties for non-performance are often negligible or not enforced by the Ministry, resulting in suppliers not prioritizing Ministry contracts. Penalties imposed on suppliers should correspond to losses incurred by the Ministries for not receiving the goods or services, and should be rigorously enforced by the Ministries.

The Government of Iraq should consider expanding contract awarding guidelines to include factors such as local and international reputation, proposed timeframe and past performance in the contract award criteria. Additional contract award criteria would assist the Ministry in attracting reliable suppliers.

3.5 Contract administration

We found that there were delays in opening LCs by the Ministry of Trade, resulting in delays in the provision of food rations to the Iraqi people. The delays were due to a number of factors, including administrative errors, unskilled staff, and the lengthy approval and funding processes.

The Ministry of Trade should perform a review of its LC opening procedures to reduce the time required to reduce the LC opening period.
3.6 Timely payment of suppliers invoices

We found a number of cases where invoices submitted to Ministries were unpaid for a period of several months, due to lengthy administrative procedures. The delay in supplier payments in certain cases has resulted in the interruption of services or delays in the delivery of goods. Furthermore, significant delays in the payment process may be an indication of fraudulent activities.

Line Ministries should perform a review of the payment process with the aim of reducing the payment period. Furthermore, the line Ministries should prepare, on a monthly basis, an aged accounts payable report detailing outstanding invoices by date and should follow up on long overdue payments.

3.7 Contract file management

We found that contract documentation at the Ministries, including all bidding, awarding, payment and contract modification documents were not maintained in a single, orderly contract file. The absence of a single, orderly contract file results in a lack of transparency in the contracting procedures of Ministries and may lead to contract terms not being adhered and the lack of visibility of projects.

Furthermore, the absence of a centralized contract file may prevent contract administrators being able to properly manage the contract and auditors being able to complete audit procedures.
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4 Contracts administered by the US Agencies

In July 2004, a DFI sub-account was established at the FRBNY by the Government of Iraq to fund contracts of the former CPA, requiring payment after 28 June 2004. The CBI has signing authority over this account and processes instructions received from the US Agencies after receiving approval by the MoF.

DFI contracts entered into by the former CPA are administered by US Agencies including the Joint Contracting Command – Iraq (JCC-I), the US Army Corps of Engineers (USACE) and Coalition Forces in Iraq. The accounting function is performed by the DFI Disbursing Office. During the course of our work at the US Agencies, we noted the following matters:

4.1 Handover of DFI contract administration

The authorization to administer DFI funded contracts is due to expire on 31 December 2005. We were informed that US Agencies have formed a committee to manage the handover of the administration of DFI funded contracts. Currently, US Agencies are performing procedures in preparation of the handover, including closing contracts and collecting available disbursement documents. However, we found that US Agencies have not developed a comprehensive strategy and implemented procedures for the handover of DFI contract administration to the Government of Iraq.

US Agencies should develop and agree a comprehensive handover strategy with the Government of Iraq.

4.2 Contractual commitments

In our prior Management Report for the period to 31 December 2004, we noted that US Agencies did not maintain a complete and accurate database of outstanding contractual commitments for contracts signed by the former CPA. During the period to 30 June 2005, a list of contractual commitments was established by a US Agency. We found a number of cases where contract values and payments on contracts were incorrectly recorded in the list.

Consequently, cash requirements to fund open contracts remain unclear, potentially resulting in the DFI sub-account containing surplus funds which could be used for the benefit of the Iraqi people. The US Agency tasked with administering and closing DFI funded contracts should ensure that all payments included in the financial records maintained by the DFI Disbursing Office are included in the contract database. Performing this procedure will ensure that the database contains all DFI funded contracts signed by the former CPA. Additionally, all contract values entered in the database should be agreed to contract files.
Furthermore, we were informed that the USACE expects to receive a further $180,789,505 for open DFI funded contracts, and task orders for fuel imports and the restoration of oil infrastructure. During the course of our procedures we found that the DFI Disbursing Office and JCC-I were originally unaware of these outstanding commitments. We were informed that US Agencies are currently coordinating with the USACE to agree the source of funding for these commitments.

The USACE should confirm all commitments still outstanding against DFI funded contracts and task orders. Furthermore, US Agencies should agree these commitments with the USACE and discuss resolution of the agreed commitment with the Government of Iraq.

4.3 US Agency Investigations

We found that US Agencies did not maintain a list of all investigations on DFI funded contracts and on individuals responsible for disbursements of DFI funds. A complete, centralized list of all investigations, and results of these investigations, should be maintained by US Agencies to improve the transparency of US Agency utilization of DFI funds and the timely assessment of potential DFI liabilities. This list should be provided to the Government of Iraq and the IAMB.
Update on our previous Management Report

During the course of our procedures we noted that all matters noted in our previous Management Report for the period to 31 December 2004, were still applicable, except as noted in the following points with reference to that report:

2.1 Unreconciled exports from Iraq

During the period to 31 December 2004, we noted unreconciled quantities of fuel oil. During the current period, we noted a substantial decrease in the export of fuel oil compared to prior periods. We were specifically denied access to the relevant accounting records in the Ministry of Oil. The Government of Iraq should investigate this matter.

2.2 Metering system

We were informed that US Agencies would provide technical assistance to prepare a statement of work for use in the tendering process for a metering system.

We were also informed that US Agencies have commenced a fifteen-month reconstruction project at the Basra Oil Terminal utilizing US Agencies’ funds. The reconstruction will include installation of a metering system at the terminal. The Basra Oil Terminal accounts for approximately 90% of export sales through the south of Iraq.

2.3 Proceeds of export sales and barter transactions

We found that during the period to 30 June 2005, $79,716,000 of proceeds from the export sales of petroleum and petroleum products were deposited into bank accounts controlled by SOMO (period to 31 December 2004: $77,724,019).

We also found that, during the current period, the volume of barter transactions had substantially reduced. From the period to 30 June 2005, SOMO had entered into barter transactions amounting to $99,896,000 (period to 31 December 2004: $134,728,698).

In accordance with UNSCR 1483, all proceeds from the export sales of petroleum and petroleum products are required to be deposited in the OPRA account, and thereafter 95% of proceeds are deposited into the DFI, with 5% deposited in the Compensation Fund. The Government of Iraq should cease barter transactions and ensure that all proceeds from the sale of petroleum and petroleum products are deposited in the OPRA account.
2.4 Accounting records

We noted in our previous Management Letter that accounting transactions for the import of light petroleum products were not recorded on a timely basis. During the current period we also found that exports of petroleum products were not recorded on a timely basis.

We found that these delays, often for several months, were due to delays in receipt of shipping documents from the Distribution Company (a division of the Ministry of Oil) and by administrative delays at SOMO.

3.3 Use of unauthorized LC providers

There has been no further funding of LCs through Lebanese Banks. A balance of $147,901,879, as at 30 June 2005, is held at these banks. The Government of Iraq should investigate the performance of these contracts and in the event of non-performance, ensure that funds are returned to the DFI.

6.1 Administration

We note that JCC-I has been appointed as the ultimate responsible entity for DFI funded contracts administered by US Agencies.