

Development Fund for Iraq

**Report of Factual Findings
in connection with the
Oil Proceeds Receipts Account**

For the period from 29 June 2004 to 31 December 2004

KPMG Bahrain

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This report contains 9 pages



**Audit & Risk Advisory Services
Iraq Desk**

PO Box 710
Manama
Kingdom of Bahrain

Chamber of Commerce Building
King Faisal Highway
Manama, Kingdom of Bahrain

Telephone +973 (-) 17224807
Fax +973 (-) 17227443
e-Mail: kpmgbh@kpmg.com

Report of Factual Findings
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To the Government of Iraq
To the International Advisory and Monitoring Board of
the Development Fund for Iraq

We have performed the procedures enumerated in the attached Appendix A, which were agreed with the Government of Iraq and the International Advisory and Monitoring Board of the Development Fund for Iraq, solely to assist you in evaluating the Development Fund for Iraq's compliance with United Nations Security Council Resolution (UNSCR) 1483 paragraphs 20 and 21, for the period from 29 June 2004 to 31 December 2004. The Government of Iraq was responsible for the Development Fund for Iraq's compliance with UNSCR 1483.

This Agreed-Upon Procedures engagement was conducted in accordance with the International Standard on Related Services 4400: *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information* and with the International Organization of Supreme Audit Institutions (INTOSAI) Standards on Government Auditing.

The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described in Appendix A, either for the purpose for which this report has been requested or for any other purpose.



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1 Reconciliation of export sales to SOMO sales ledger and to FRBNY

1.1 Procedure

We obtained from the State Oil Marketing Organization (SOMO) a list of export sales of petroleum (crude oil), petroleum products (mainly fuel oil) and natural gas for the period from 29 June 2004 to 31 December 2004, and compared this total to the SOMO sales ledger.

Findings

- 1.1.1 As there is no infrastructure in Iraq for the export of natural gas, there were no export sales of natural gas from Iraq.
- 1.1.2 We found that SOMO's sales ledger reconciled to SOMO's list of export sales of petroleum and petroleum products for the period from 29 June 2004 to 31 December 2004.
- 1.1.3 We obtained a list of nominated vessels from a US Navy Commander detailing all vessels monitored by the Coalition Naval Forces in the Arabian Gulf. We agreed each vessel to the SOMO list of export sales of petroleum, which also includes nominated vessels.
- 1.1.4 We found that during the period from 29 June 2004 to 31 December 2004, SOMO held contracts with 30 customers for export sales of petroleum.
- 1.1.5 We found that export sales of petroleum and petroleum products were made through letters of credit (LCs), cash and barter transactions, as recorded in SOMO's accounting records for the period from 29 June 2004 to 31 December 2004, were as follows:

	Petroleum	Petroleum Products	Total
LCs	\$ 9,444,220,019	\$ 820,080	\$ 9,445,040,099
Cash received	-	77,724,019	77,724,019
Barter transactions	<u>60,567,275</u>	<u>74,161,423</u>	<u>134,728,698</u>
	<u>\$ 9,504,787,294</u>	<u>\$ 152,705,522</u>	<u>\$ 9,657,492,816</u>

The amount of export sales of petroleum made through LCs includes interest receipts of \$44,368 for delayed bank transfers, and is net of demurrage claims paid of \$4,919,376.

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1.2 Procedure

We compared the list of export sales to amounts deposited into the OPRA account, held on behalf of the CBI at the FRBNY.

Findings

LCs

- 1.2.1 We found proceeds from export sales of petroleum and petroleum products for the period from 29 June 2004 to 31 December 2004, were deposited into the OPRA account approximately 30 days after lifting, in accordance with the terms of the LCs, as follows:

Deposited in OPRA for the period:

29 June 2004 to 31 December 2004	\$ 8,118,513,333
Subsequent to 31 December 2004	<u>1,326,526,766</u>
	<u>\$ 9,445,040,099</u>

- 1.2.2 We found LCs amounting to \$1,581,328 issued in early 2004 for exports sales of fuel oil, to the Far East market, are still outstanding as at the date of this report. We were informed by the CBI that documentation required under the LC terms was issued to the correspondent bank subsequent to the LCs deadline. Payment has been refused by the correspondent bank and the customer. SOMO is pursuing these funds.

Cash

- 1.2.3 We found that cash advances received for, and proceeds of, export sales of petroleum products during the period from 29 June 2004 to 31 December 2004 amounted to \$77,724,019 (from inception (22 May 2003) to 31 December 2004: \$97,762,019), were not deposited into the OPRA account, nor the DFI or the Compensation Fund, in accordance with UNSCR 1483. These funds were deposited in two Iraqi bank accounts and one Jordanian bank account controlled by SOMO.

During the period from 29 June 2004 to 31 December 2004, SOMO transferred \$24,178,478 (from inception to 31 December 2004: \$24,178,478) to the Ministry of Oil. The balance of the SOMO bank accounts as at 31 December 2004 is \$73,583,542 (28 June 2004: \$20,038,000), including prior period transactions.

Barter transactions

- 1.2.4 We found that SOMO engages in barter transactions for exports of petroleum and petroleum products. These barter transactions consist mainly of exports of residual fuel oil in exchange for light petroleum products, and the export of crude oil in exchange for electricity and light petroleum products from the Government of Syria.

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1.2.5 The value and volume of these barter transactions for the period from 29 June 2004 to 31 December 2004, as recorded by SOMO, were as follows:

	Petroleum	Petroleum	Total
	Products	Products	
June (2 days)	\$ -	\$ 1,530,539	\$ 1,530,539
July	3,752,480	18,870,442	22,622,922
August	12,927,992	26,271,013	39,199,005
September	12,392,100	19,433,261	31,825,361
October	14,758,982	3,314,018	18,073,000
November	9,477,494	2,161,282	11,638,776
December	<u>7,258,227</u>	<u>2,580,868</u>	<u>9,839,095</u>
	<u>\$ 60,567,275</u>	<u>\$ 74,161,423</u>	<u>\$ 134,728,698</u>
Volume	<u>Barrels: 2,125,681</u>	<u>Tons: 759,281</u>	

The value of the barter transactions for the period from inception to 31 December 2004, was \$461,208,631.

As these were non-cash transactions, no proceeds were deposited in the OPRA account, nor the DFI or the Compensation Fund.

1.2.6 During the period from 29 June 2004 to 31 December 2004, the Ministry of Finance authorized a funding allocation of \$1,150,000,000 to SOMO for the import of light petroleum products, commencing during August 2004. Accordingly, the volume of barter transactions decreased substantially, except for the aforementioned barter of crude oil with the Government of Syria.

1.2.7 Since September 2003, SOMO engaged in barter transactions for electricity and light petroleum products with the Government of Syria. The import of electricity ceased on 1 September 2004, but exports of crude oil to Syria continued. Regular reconciliations between crude oil and fuel oil exported and electricity and light petroleum products imported are performed by SOMO. The balance as at 28 February 2005 of \$18,736,092, as calculated by SOMO, had not yet been confirmed to SOMO by the Government of Syria as at the date of this report. SOMO has requested this amount be paid to the DFI account at the FRBNY rather than through an exchange of products.

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Unreconciled and unauthorized Exports from Iraq

- 1.2.8 We obtained from the Ministry of Oil a reconciliation of the quantity of fuel oil produced, consumed locally, injected into the pipeline and wells, and exported. We found that this reconciliation contained unreconciled quantities of 618,203 tons for the period from 29 June 2004 to 31 December 2004. Without an adequate explanation for the unreconciled quantities, the implication is that fuel oil produced was greater than that consumed locally, injected into the pipeline and wells, and exported by 618,203 tons.

Consistent with these unreconciled quantities, we noted that export sales of fuel oil, as recorded by SOMO, decreased by 561,596 tons, from 1,643,336 tons for the period from 1 January 2004 to 28 June 2004, to 1,081,740 tons for the period from 29 June 2004 to 31 December 2004. Furthermore, the recorded export sales of fuel oil from 1 October 2004 to 28 February 2005 have decreased from an average of 282,000 tons per month, for the period from 1 January 2004 to 30 September 2004, to less than 57,000 tons per month.

The estimated sale value of the unreconciled quantities is approximately \$69,000,000, when calculated using an average price per ton for fuel oil export sales for the current period.

We were not provided with a satisfactory explanation for the either unreconciled quantities or sales decrease of fuel oil.

- 1.2.9 The former CPA believed that an unknown quantity of petroleum and petroleum products was smuggled from Iraq, bypassing the authorized processes of marketing, sales and cash collection. Despite internal controls put in place by the Ministry of Oil, SOMO and the former CPA, the Government of Iraq believes that in the absence of a fully operational metering system, it is not possible to determine the volume of all exports of petroleum and petroleum products, for which proceeds are required to be deposited in the OPRA account.

It was not practicable for us to extend our procedures sufficiently to quantify such amounts.

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2 Oil Proceeds Receipts Account

2.1 Procedure

We recalculated the amounts to be transferred from the OPRA account during the period from 29 June 2004 to 31 December 2004, pursuant to the allocation requirements of UNSCR 1483 paragraphs 20 and 21, and agreed these payments to the cash deposited in the DFI and to the cash transferred to the Compensation Fund.

Findings

2.1.1 The proceeds of export sales of petroleum and petroleum products were deposited in the OPRA account and immediately thereafter, 95% was deposited in the DFI and the remaining 5% was deposited in the Compensation Fund. The Compensation Fund was established in accordance with UNSCR 687 and subsequent relevant resolutions, as a result of the Iraqi invasion of Kuwait during 1990.

2.1.2 The proceeds resulting from export sales of petroleum and petroleum products, deposited in the OPRA account and immediately transferred to the DFI and the Compensation Fund during the period from 29 June 2004 to 31 December 2004, are as follows:

Period of export	OPRA	DFI	Compensation Fund
29 June 2004 to 31 December 2004	\$ 8,118,513,333	\$ 7,712,587,666	\$ 405,925,667
1 January 2004 to 28 June 2004	<u>1,201,818,222</u>	<u>1,141,727,311</u>	<u>60,090,911</u>
	<u>\$9,320,331,555</u>	<u>\$ 8,854,314,977</u>	<u>\$ 466,016,578</u>

\$1,201,818,222 represents the proceeds of exports sales of petroleum and petroleum products during the period from 1 January 2004 to 28 June 2004, which were deposited in the OPRA account during the period from 29 June 2004 to 31 December 2004.

2.1.3 We found that the allocation was pursuant to UNSCR 1483 paragraphs 20 and 21.

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3 Compensation Fund

3.1 Procedure

We obtained a letter from the United Nations confirming the amount transferred from the OPRA account to the Compensation Fund during the period from 29 June 2004 to 31 December 2004.

Findings

- 3.1.1 We agreed the amount transferred from the OPRA account to the Compensation Fund, to the amount confirmed by the United Nations for the period from 29 June 2004 to 31 December 2004.
- 3.1.2 We noted that cash held in the Compensation Fund as at 31 December 2004 was \$504,715,000, as stated in the Unaudited Financial Statements of the Compensation Fund for the year ended 31 December 2004, provided to us by the United Nations.

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Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the Oil Proceeds Receipts Account for the period from 29 June 2004 to 31 December 2004. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We have performed an examination of the statement of cash receipts and payments of the Development Fund for Iraq for the period from 29 June 2004 to 31 December 2004, with our audit report issued thereon on 6 April 2005. We expressed a qualified audit opinion on the completeness of cash receipts, as also noted in our findings in section 1.2.3. We further expressed a qualified audit opinion on the completeness of export sales of petroleum and petroleum products, as also noted in our findings in sections 1.2.8 and 1.2.9. Furthermore, we expressed a qualified audit opinion on the completeness and accuracy of contractual commitments.

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 statement is shown or into whose hands it may come save where expressly agreed by our consent in writing.

Manama, Kingdom of Bahrain
6 April 2005

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Development Fund for Iraq
Agreed-Upon Procedures
in connection with the Oil Proceeds Receipts Account
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Appendix A

In accordance with the engagement letter issued on 13 December 2004, the procedures to be applied to the OPRA account held on behalf of the Central Bank of Iraq at the FRBNY are as follows:

1. Obtain from SOMO:
 - 1.1 A list of export sales, and agree the list of export sales to SOMO's sales ledger;
 - 1.2 Agree the list of export sales to the amounts deposited in FRBNY.
2. Recalculate the amounts to be transferred from the OPRA account, pursuant to the allocation requirements of UNSCR 1483 paragraphs 20 and 21, and agree these payments to the cash deposited in the DFI and to the cash transferred to the Compensation Fund.
3. Obtain a confirmation from the United Nations regarding the amounts transferred from the OPRA account to the Compensation Fund during the period from 29 June 2004 to 31 December 2004.