

DEVELOPMENT FUND FOR IRAQ

Report of Factual Findings

In Connection With Oil Export Sales

For the Period From
July 1, 2005 to December 31, 2005



Private and confidential

July 10, 2006

**To Government of Iraq
To International Advisory and Monitoring Board
of Development Fund for Iraq**

REPORT OF FACTUAL FINDINGS - OIL EXPORT SALES

We have performed the procedures agreed with you and set out in Appendix A of the attached report with respect of export sales of petroleum and petroleum products of the Development Fund for Iraq. Our engagement was undertaken in accordance with International Standard on Related Services (ISRS) No. 4400, engagement to perform agreed-upon procedures regarding financial information. The procedures were performed solely to assist the International Advisory and Monitoring Board (IAMB) and the Iraqi Governmental (IG) in evaluating the Development Fund for Iraq's compliance with United Nations Security Council Resolution (UNSCR) 1483 paragraph 20 and 21, for the period from July 1, 2005 to December 31, 2005. The Government of Iraq was responsible for the Development Fund for Iraq's compliance with UNSCR 1483.

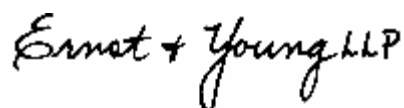
We have reported our findings in sections 1 to 4 in the attached report.

Because the procedures, which are detailed in Appendix A to this report, do not constitute 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.

Had we performed additional procedures or had we performed an audit or review made in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for the information of IAMB and IG and is not to be used for any other purpose or to be distributed to any other parties. We do not accept or assume responsibility for any other purpose or to any other person who may receive this agreed upon procedures report. This report relates only to the accounts and items specified in Appendix A of the attached report and does not extend to any financial statements of Development Fund for Iraq taken as a whole.

Yours faithfully
Ernst & Young



Baghdad, Iraq

1 KEY INTERNAL CONTROLS OVER THE RECORDING OF EXPORT SALES

1.1 PROCEDURE

We documented the key internal controls employed by the Ministry of Oil and the Ministry of Oil and the State Oil Marketing Organization (SOMO), the sales arm of the Ministry of Oil over the capture of revenue from export sales of petroleum, petroleum products and natural gas and subsequent cash deposits in the DFI.

KEY INTERNAL CONTROLS

The key internal controls noted during the period from July 1, 2005 to December 31, 2005 are consistent with the controls of the prior period as follows:-

- The former Coalition Provisional Authority (CPA) issued Order Number 36, Regulation of Oil Distribution, on October 3, 2003 to supplement Iraqi law and to support the Iraqi authorities in the lawful distribution of oil into, out of and throughout Iraq. It was designed to assist in preventing theft and smuggling of natural resources, pending the outcome of a full review of Iraqi law, provisions and instructions.
- The Ministry of Oil regularly visits SOMO and other state-owned oil companies to review management information regarding oil production, shipping and transportation and distribution.
- SOMO maintains a spreadsheet tracking ship movements to ensure that, for all lifted petroleum, ships were nominated and authorized, were loaded in accordance with contractual provisions; an invoice raised; and, the proceeds deposited in the Federal Reserve Bank of New York (FRBNY).
- The policy of the Government of Iraq is to engage international security companies and local tribes to guard the pipelines and installations against sabotage.
- Export sales of petroleum and petroleum products are required to be exclusively arranged and invoiced by SOMO.
- SOMO's policy for export sales of petroleum is to accept payments primarily through irrevocable documentary letters of credit (LCs), ensuring that full payment is received for all exports. A limited number of barter transactions for exports of petroleum are also entered into with the Government of Syria.
- SOMO's policy for export sales of petroleum products is to sell primarily through cash advance payments and barter transactions.
- Cash receipts for export sales of petroleum through LCs are to be deposited directly into the Oil Proceeds Receipts Account (OPRA) at the FRBNY.
- For each shipment, SOMO is to perform a matching process of Bills of Lading, Certificates of Quantity and Quality, Ullage Reports, Export Cargo Manifests and Master Receipts against invoices raised, to ensure that all shipments are appropriately invoiced.

OTHER CONTROLS NOTED

- For each scheduled shipment of export sales of petroleum, a Loading Card is opened by SOMO's shipping department to ensure that scheduled shipments do not commence until the finance department receive a copy of the opened letter of credit from the CBI and confirm that the contractual requirements related to the letter of credit are met.
- The loading of each vessel is made by the North and South Oil Company based on the approved loading schedules received from SOMO's shipping department.
- SOMO's shipping department checks the Bills of Lading, Certificates of Quantity and Quality, Ullage Reports, Export Cargo Manifests and Master Receipts, which are prepared by the oil production company for each shipment to the approved loading schedule.
- Also, SOMO's shipping department compares these documents with the approved loading schedule and documents the actual loaded quantities on the opened loading card.
- The finance department checks the loaded quantity reported in the Loading Card prepared by the shipping department and to the related supporting documents.
- The finance department calculates the price of each shipment based on the monthly approved OSP and documents this calculation in the Loading Card and the Access database.
- For each shipment of export sales of petroleum, SOMO's marketing department checks and approves the price used in the Loading Card.
- Based on the approved price in each Loading Card, the finance department prepares the sales invoices, which are approved by the Finance Manager before being issued to the customer.

FINDINGS

Key internal controls tested together with our findings are noted in sections 3 and 4.

2 KEY INTERNAL CONTROLS OVER THE BIDDING PROCESS

2.1 PROCEDURES

We documented key internal controls to be employed by the Ministry of Oil and SOMO over the bidding on and awarding of export sales contracts.

KEY INTERNAL CONTROLS

The key internal controls noted during the period from July 1, 2005 to December 31, 2005 are consistent with the controls of the prior period as follows:-

BASRA LIGHT OIL

- SOMO's policy is to sell Basra light oil through medium-term contracts (six months), primarily to well-known international oil companies, with up to 5% of sales being made to reliable oil traders. All contracts are to be approved by the Minister of Oil.
- Contracts for Basra light oil are to be entered into based on production plans and estimates of capacity received from the South Oil Company, a state-owned entity. The price of petroleum to be delivered under these contracts is required to be SOMO's Official Selling Price (OSP) for the scheduled month of loading.

The OSP is required to be based on one of three international benchmarks, depending on the destination: WTI (second month) for American destination; Brent dated for European destination; and Oman/Dubai average for Far East destination, as quoted in PLATTS daily publications.

The OSP, for European and American destinations, is required to be calculated using an average of PLATTS quotations, for five consecutive quotations starting on the 15th day from the date of the bill of lading.

The OSP, for Far East destination, is required to be calculated using a monthly average of PLATTS quotations, during the calendar month of loading.

The PLATTS averages, as calculated above, for the three destinations are then required to be entered into a price formula, which includes factors for quality differential from the benchmarks and transportation costs.

- The OSP, including discounts for quality differential from the benchmarks and transportation costs, is required to be published on a monthly basis for all customers, by the 10th day of the month preceding the month of loading. The Minister of Oil is to approve all OSPs.

KIRKUK PETROLEUM

- Due to continuous disruption of production by sabotage of Kirkuk's pipelines, SOMO initiates a bidding process as and when sufficient quantities of petroleum have been accumulated in Iraqi storage tanks in Turkey.
- For Kirkuk petroleum, SOMO has a policy of selling exclusively to end-users. All contracts are to be approved by the Minister of Oil.
- SOMO's OSP for Kirkuk petroleum is required to be calculated using similar methods to those used to calculate the OSP for Basra light oil, with the following exception:

The OSP for European destination is required to be calculated using an average of PLATTS quotations, for five consecutive quotations starting from the date of the bill of lading.

- During the period from July 1, 2005 to December 31, 2005, SOMO had only one bid announcement for Kirkuk petroleum. The accumulated quantity of oil announced and sold on that bid was three million barrels. This bid was granted to 3 customers.
- The bid awarding process was based on the best offered prices, the customer being selected by a bidding committee including SOMO's General Manager and approved by the Minister of Oil.

FINDINGS

Key internal controls tested with our findings are noted in sections 3 and 4.

3 RECONCILIATION OF EXPORT SALES LIST TO SOMO's SALES LEDGER AND AMOUNTS DEPOSITED AT THE FRBNY

3.1 PROCEDURE

We obtained from SOMO a list of export sales of petroleum and petroleum products for the period from July 1, 2005 to December 31, 2005 and we agreed the total of the list to SOMO's sales ledger.

FINDINGS

- We found that no export sales of natural gas took place in Iraq during the period from July 1, 2005 to December 31, 2005, due to the absence of infrastructure for the export of natural gas.
- We found that SOMO does not properly prepare and document the reconciliation of its export sales records with the sales proceeds deposited at the DFI's account on a monthly basis.
- We found that the total export sales and barter transactions of petroleum and petroleum products for the period from July 1, 2005 to December 31, 2005, were as follows:

	U.S.\$		
	Export Sales	Barter	Total
Petroleum	12,872,584,674	68,989,566	12,941,574,240
Petroleum Products	218,681,669	9,575,351	228,257,020
Total	13,091,266,343	78,564,917	13,169,831,260

- We reconciled the total amount of export sales detailed list of petroleum with SOMO's sales ledger for the period from July 1, 2005 to December 31, 2005, as follows:

	<u>U.S. \$</u>
List of export sales of petroleum	12,872,584,674
Debit note	434,957
Credit note	(45,418)
Sales ledger balance	<u>12,872,974,213</u>

- We found that the amount of export sales made through LCs includes interest received of U.S.\$ 95,464 for delayed bank transfers, and is net of paid demurrage claims of U.S.\$15,418,783 incurred during the period from July 1, 2005 to December 31, 2005.

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- We found that total petroleum export sales from Basra and Kirkuk for the period from July 1, 2005 to December 31, 2005 was as follows:

	Export Sales U.S. \$	Barrels
Basra	12,267,379,812	243,139,802
Kirkuk	605,204,862	11,049,808
Total	12,872,584,674	254,189,610

3.2 PROCEDURE

We compared the list of export sales for the period from July 1, 2005 to December 31, 2005 to the amounts deposited into the OPRA account held at the FRBNY.

FINDINGS

Letters of Credit

- We found proceeds from export sales of petroleum made through letters of credit for the period from July 1, 2005 to December 31, 2005, were collected within approximately 30 days from the date of Bill of Lading and in accordance with the letter of credit provisions.
- We reconciled the list of export sales of petroleum as stated in SOMO's records to the amounts deposited in the OPRA at the FRBNY as follows:-

	<u>U.S.\$</u>
List of export sales per SOMO's records	12,872,584,674
Add:	
Deposits during July 2005 related to prior period export sales	2,014,394,657
Debit Note	434,957
Interest on delayed payments	95,464
Less:	
Deposits during January 2006 related to December 2005 export sales	(1,499,351,555)
Deducted demurrage from invoices	(15,418,783)
Credit Note	(45,418)
	<u>13,372,693,996</u>
Deposits at the OBRA account per CBI's records	
Sales invoice not included in FRBNY confirmation of OBRA statement	106,236,855
Deposits at the OBRA per FRBNY confirmation	<u>13,266,457,141</u>

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- We found that proceeds from export sales of petroleum for the period prior to July 1, 2005 of U.S.\$2,014,394,657 were deposited into the OPRA account approximately 30 days after the lifting in accordance with the terms of LCs during the period from July 1, 2005 to December 31, 2005.
- We found that proceeds from export sales of petroleum for the period from July 1, 2005 to December 31, 2005 of U.S.\$1,499,351,555 were deposited into the OPRA account approximately 30 days after the lifting, in accordance with the terms of LCs in the period subsequent to December 31, 2005.
- We found that SOMO issued a debit note of U.S.\$ 434,957 as a price adjustment for discharging part of the lifting at a port other than the scheduled destination.
- We found that a credit note of U.S.\$ 45,418 was issued by SOMO to Hindustan Petroleum Limited as price adjustment to rectify error in computing sales price (due to using an average of the month of PLATTS quotations up to October 30, 2005, but should have been up to October 31, 2005).
- We found that the amount of export sales made through LCs includes interest received of U.S.\$ 95,464 for delayed bank transfers during the period from July 1, 2005 to December 31, 2005.
- We found that the amount of export sales made through LCs is net of paid demurrage claims of U.S.\$ 15,418,783 incurred during the period from July 1, 2005 to December 31, 2005.
- We found that sales invoice no. B/2005/263 amounting to U.S.\$ 106,208,092, with interest of U.S.\$ 28,763, recorded by SOMO deposited in the OPRA on October 3, 2005 through letter of credit number 05/227, was not listed on the OPRA statement received from FRBNY. We have requested but not yet received from FRBNY clarification for this amount.
- We found that sales invoice no. B/2005/263 amounting to U.S.\$ 106,208,092, with interest of U.S.\$ 28,763, recorded by SOMO deposited in the OPRA on October 3, 2005 through letter of credit number 05/227, was not listed on the OPRA statement received from FRBNY. We have requested but not yet received from FRBNY clarification for this amount.
- We found that SOMO does not properly prepare and document the reconciliation of its export sales records with the sales proceeds deposited at the DFI's account on a monthly basis.

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- We reconciled the list of export sales of petroleum as stated in SOMO's records to the amounts recorded by the oil production companies for the period from July 1, 2005 to December 31, 2005 as follows:-

Port	Oil Production Figures / Barrels	SOMO Figures / Barrels	Difference
Kirkuk	11,049,808	11,049,808	-
Basra	242,294,268	243,139,802	845,534
	253,344,076	254,189,610	845,534

- We requested but have not yet received clarification from SOMO of the above reported difference.

Petroleum Products

- We found that all export sales of petroleum products during the period from July 1, 2005 to December 31, 2005 were collected through cash advance payments, except for a limited number of barter transactions.
- We found that cash proceeds from export sales of petroleum products amounted to U.S.\$ 211,421,722 for the period from July 1, 2005 to December 31, 2005 were not deposited at the DFI's account in accordance with UNSCR 1483; instead, these funds were deposited into three SOMO banks accounts.
- We found that the monthly export sales of petroleum products, excluding barter sales, during the period from July 1, 2005 to December 31, 2005 were as follows:

	<u>U.S.\$</u>
Export sales of petroleum products	218,681,669
Total proceeds deposited at local banks	<u>211,421,722</u>
	<u>7,259,947</u>

- We requested but have not yet received clarification from SOMO of the above reported difference.
- We found that SOMO finance department does not properly prepare and document the reconciliation of its records of export sales of petroleum products with SOMO's bank accounts on a monthly basis.

Barter Transactions

- SOMO engaged in barter transactions with the Syrian Government for export of petroleum and petroleum products. Barter transactions were mainly in the form of exporting petroleum in exchange of electricity and petroleum products, and exporting fuel oil in exchange of petroleum products.

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- We found that, as barter transactions are non cash transactions, no cash was deposited at the DFI's account at the FRBNY. Consequently, no cash was transferred to the OPRA, DFI or Compensation Fund.
- We reconciled the total of barter transactions with the Syrian Government from SOMO for the period from July 1, 2005 to December 31, 2005 as follows:-

	<u>U.S.\$</u>
Due to Syrian Government as of July 1,2005	(4,893,949)
Adjustments related to prior period	*(1,021,733)
Imports:	
Electricity	(20,125,728)
Petroleum products	(34,197,508)
Exports:	
Crude oil	68,989,566
Fuel oil	9,575,351
Due from Syrian Government as of December 31, 2005	<u>18,325,999</u>

- We found that the adjustments related to prior period related to differences arising on the measurement of quantities of barter transactions in prior periods and have been approved by the Ministry of Oil's consultant.

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- We requested but did not yet receive direct confirmation from the Syrian Government to confirm the quantities and amount of the barter transactions during the period from 1 July, 2005 and 31 December, 2005 and the accounts receivables balance as of 31 December, 2005.
- We did not perform any procedures on the imports from the Syria Government as this is not part of our scope of work.
- We found that a summary of the monthly barter transactions of petroleum and petroleum product with the Syrian Government for the period from July 1, 2005 to December 31, 2005 to be as follows:

	U.S.\$		
	Petroleum	Petroleum Products	Total
July	13,990,742	1,169,971	15,160,713
August	20,329,033	1,246,072	21,575,105
September	4,162,777	3,467,042	7,629,819
October	18,130,550	3,341,774	21472324
November	12,376,464	313,704	12,690,168
December	-	36,788	36,788
	68,989,566	9,575,351	78,564,917

Internal Controls

- We found that there is no fully operational metering system and due to the continued sabotage of the pipelines, it is not possible to determine the volume of all exports of petroleum and petroleum products, for which proceeds are to be deposited in the OPRA.
- We found that there is no reconciliation prepared between the total quantity of petroleum extracted from producing wells with the total quantity of petroleum exported and delivered to local refineries and other local users.
- We found that there is no fully operational metering system at the local refineries, and it is not possible to determine the volume of petroleum delivered to the local refineries.
- Due to weaknesses in the internal control systems, we could not extend our procedures sufficiently to determine such volume.

4 TESTING EXPORT SALES OF PETROLUEM AND PETROLUEM PRODUCTS

For all export sales of petroleum and a selected sample of petroleum products covering 74% of total value of petroleum products, we performed the following:

4.1 PROCEDURE

We determined whether internal control procedures, noted in section 2 of this report, for the bidding on and awarding of contracts to which the sale related were followed.

FINDINGS

- We found that SOMO does not have formal documented policies and procedures for contract bidding and awarding of export sales approved by the IG.
- During the period from July 1, 2005 to December 31, 2005, we found that SOMO did not initiate contract bidding procedures for export sales of petroleum and petroleum products sales, except for one bid for part of a shipment from Kirkuk.
- We found that the minutes of meetings of petroleum and petroleum products awarding committee were not fully and formally documented.
- We found that a list of contracts awarded was signed by the General Manager and approved by the Minister of Oil.
- We found that SOMO used past performance and international reputation of the existing customers as the main criteria for awarding process but no reports are available documenting the performance analysis and due diligence performed to make this assessment.
- We found that export sales of petroleum through Kirkuk include deliveries by pipeline to Turkish Petroleum Refineries Corporation (TUPRAS) without any bid process during the period from 1 July, 2005 to 31 December, 2005.
- We found that the OSP used for TUPRAS was the average of PLATTS quotations less API escalation less best discount obtained on SOMO's last announced bid.

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- For the period from July 1, 2005 to December 31, 2005, we found that SOMO has signed contracts for export sales of petroleum for Basra and Kirkuk with the following customers:

Destination	Company Name
North and South America	Exxon Mobil Sales and Supply Corp.
	Chevron Texaco Products Company
	Koch Supply & Trading Company LP
	ConocoPhillips International Inc.
	Marathon Ashland Supply
	North Atlantic Refining (Bermuda) LTD
	Valero Marketing & Supply Co.
Europe	BP Oil International
	Shell Int'l Trading and Shipping Company
	Total International Limited
	Repsol YPF Trading Y Transporte, S.A.
	Eni S.P.A. Refining and Marketing Division
	Taurus Petroleum Limited
	Petrogal S.A Lisbon
	Compania Espanola de Petroleos
Turkish Petroleum Refineries Corp	
Far East	Petro Diamond Company
	China Int'l United Petroleum & Chemicals
	Petrobras Int'l Finance Company
	China National United Oil Corporation
	Reliance Industries
	Chinese Petroleum Corporation
	SK Corporation
	Sinochem Int'l Oil (London) Co.
	Hindustan Petroleum Corporation
	Indian Oil Corporation
	Thai Petrochemical Industry Public Company
	Avin Oil Anstalt – Greece

- We found that export sales of Basra petroleum were made through medium-term contracts to international end users and oil traders and export sales of Kirkuk petroleum were sold through short-term contracts to international end users only.

4.2 PROCEDURE

We observed wither the contracts and sales invoices were signed and approved by an authorized person in accordance with SOMO policies and procedures, and approved by the Minister of Oil.

FINDINGS

- We found that SOMO does not have formal documented policies and procedures for the preparation, review and approval of sales invoices.
- We found that SOMO does not have a formal documented delegation of authority or list of authorised signatories.
- We found that sales invoices were signed by the Finance Manager, except for 116 sales invoices which were signed by other members of SOMO's senior management.
- We found that the finance department generates invoices using an internally developed Access database but serial numbers are entered manually.

4.3 PROCEDURE

We compared the quantities and prices as per invoice to the Sales Contracts, Bills of Lading, Certificates of Quantity and Quality, Ullage Reports, Export Cargo Manifests and Masters Receipts.

FINDINGS

- We found that for all recorded petroleum export sales and the tested sample of the recorded petroleum products, quantities and prices in the issued invoices agreed to Sales Contracts, Bills of Lading, Certificates of Quantity and Quality, Ullage reports, Export Cargo Manifests and Masters Receipts, except for the certain deviations as presented in this section.
- We found that SOMO does not obtain from its customers a certificate of discharge for each shipment to ensure the customers compliance with SOMO's contractual provisions.
- We found that there is no third party confirmation for receipt of shipments to ensure that all shipments are discharged to the intended destination in accordance with SOMO's contractual provisions.
- We found that petroleum export sales contracts state that SOMO has the right to receive verification of quantity and quality for each shipment from its customers but no such verification was obtained by SOMO.
- We found that Loading Cards, certificates of quantity and quality, Ullage reports and export cargo manifests do not have serial numbers and bills of lading are not pre-numbered.
- We found that sales invoices and supporting documents are not centrally filed in a properly organised and systematic manner.
- We found that SOMO does not have formally approved and documented procedures for demurrage claims.
- We found that demurrage payments are calculated by SOMO's marketing department, reviewed by SOMO's internal auditor and approved by the General Manager.
- We found that SOMO does not deduct demurrage claims from petroleum sales invoices until the customer provides written acceptance of SOMO's calculation.
- We found that demurrage claims for the period from July 1, 2005 to December 31, 2005 amounted to U.S.\$ 22,765,220, of which U.S.\$ 15,418,783 have been deducted against proceeds of export sales deposited at the DFI's account during the period from July 1, 2005 to December 31, 2005.

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- We found that due but unpaid demurrage claims as of December 31, 2005 were U.S.\$ 7,346,437.

4.4 PROCEDURE

We recalculated the OSP, by reference to PLATTS publications, for each lift and compare to the price per the invoice.

FINDINGS

- We found that the OSP, including discounts for quality differential from the benchmarks and transportation costs, for petroleum were distributed to customers on a monthly basis, by the 10th day of the month preceding the month of loading.
- For all export sales of petroleum and for our sample of export sales of petroleum products, we found that the price per the invoice agreed to the OSP when recalculated using PLATTS quotations, except for the following:
 - ✘ We found that the Price Differential and Freight Escalation used in the pricing of Taurus Petroleum Limited shipment dated September 19, 2005, were based on the price and freight escalation for October instead of September, which resulted in the issued sales invoice being understated by U.S.\$ 4,833,229. We have requested but not yet received clarification from SOMO relating to this.
 - ✘ We found that the OSP of a shipment to Hindustan Petroleum Corporation Limited dated October 6, 2005 for U.S.\$ 34,800,788 was computed using an average of the month of PLATTS quotations up to October 30, 2005 instead of October 31, 2005, which resulted in the issued sales invoice being over-stated by U.S.\$ 45,418. We found that a credit note was subsequently issued by SOMO to settle the difference.
- Based on our sample tested, we found that the pricing policy for the export sales of petroleum products included a discount on the PLATTS quotations to encourage customers to collect the fuel oil within Iraq and to ensure that production of refined oil is not interrupted.
- We found that discounts on fuel oil were published on a monthly basis for all customers and approved by the Minister of Oil.

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- We found that the price for export sales of petroleum products is calculated as follows:
 - Iraqi southern boarders (Khor Al-Zubair terminal): five quotations around the date of the bill of lading, using FOB Arab Gulf HSFO 180 CST quotation, less a discount of U.S.\$ 18 per ton.
 - Iraqi southern boarders (Baiji and Dorreh): monthly Average of PLATTS quotations for the month of loading using FOB Arab Gulf HSFO 180 CST quotation, less a discount of U.S.\$60 per ton for Dorreh and U.S.\$70 per ton for Baiji.
 - Iraqi western boarders (Baiji and Dorreh): monthly average of PLATTS quotations for the month of loading using FOB Med Italy 3.5% fuel oil quotations, less a discount of U.S.\$ 70 per ton.
 - Iraqi northern boarders (Baiji): monthly average of PLATTS quotations for the month of loading using FOB Med Italy 3.5% fuel oil quotations, less a discount of U.S.\$ 90 per ton.
 - Iraqi eastern boarders (Baiji and Dorreh): monthly Average of PLATTS quotations for the month of loading using FOB Arab Gulf HSFO 180 CST quotation, less a discount of U.S.\$ 90 per ton for Dorreh and U.S.\$100 per ton for Baiji.
- We found that the OSP calculation formula and the Freight Escalation formula are not formally documented as approved and that there are no documented procedures to be followed by SOMO in the calculation of the monthly OSP for each destination.
- We requested but were not provided with documentation approving the API escalation computation formula for Basra and Kirkuk petroleum.
- We found that SOMO does not have a formally documented policy for pricing delayed shipments after the original scheduled month of loading.
- We found that a letter setting out the OSP is signed by the General Manager and approved by the Minister of Oil.
- We found that no minutes of meetings of the OSP committee are maintained.
- During the period from July 1, 2005 to December 31, 2005, SOMO had three shipments to South Africa for a total amount of U.S. \$ 163,259,952 and we found that the OSP used for these shipments was month of loaded approved OSP for Europe destination except for Freight Escalation, which was calculated based on 75% of Europe destination approved freight escalation. We found that this formula was approved by SOMO's General Manager.

Appendix A

SCOPE OF WORK

According to the agreed upon scope of work, the procedures to be performed in connection with export sales of petroleum and petroleum products for the period from July 1, 2005 to December 31, 2005 are as follows:

1. Document the key internal controls designed by the IG and State Oil Marketing Organization (SOMO), the sales arm of the Iraqi Ministry of Oil, over the capture of revenue from export sales of petroleum, petroleum products and natural gas (export sales) extracted from the ground and subsequent cash deposits in the DFI.
2. Document the key internal controls designed by the IG and SOMO, over the bidding on, and awarding of, export sales contracts.
3. Obtain from SOMO a list of export sales and:
 - 3.1 Agree the total of export sales list to SOMO's sales ledger.
 - 3.2 Agree the list of export sales to the amounts deposited at the FRBNY.
4. For all export sales of petroleum and a selected sample of petroleum products perform the following:
 - 4.1 Determine whether internal control procedures, noted in point 2.2 above, for the bidding on and awarding of contracts to which the sale related were followed.
 - 4.2 Observe that contracts and sales invoices were signed and approved by an authorized person in accordance with SOMO policies and procedures, and approved by the IG.
 - 4.3 Agree the quantities and prices as per invoice to the Sales Contracts, Bills of Lading, Certificates of Quantity and Quality, Ullage reports, Export Cargo Manifests and Masters Receipts.
 - 4.4 Recalculate the OSP, by reference to PLATTS publications, for each lift and compare to the price per the invoice, and report any deviations noted.