

INTERNATIONAL ADVISORY AND MONITORING BOARD (IAMB) ON IRAQ

THIRD INTERIM REPORT COVERING THE YEAR 2007

The primary responsibility of the International Advisory and Monitoring Board (IAMB) is to promote the objectives set forth in UNSCR 1483 of ensuring that the Development Fund for Iraq (DFI) is used in a transparent manner for the benefit of the Iraqi people and that export sales of petroleum, petroleum products and natural gas are made consistent with prevailing international best practices.¹ In the period from inception in 2003 to end-June 2007 the DFI received \$98.9 billion from the proceeds of Iraqi oil export sales, balances from the UN oil-for-food program and frozen Iraqi funds, and disbursed \$89.9 billion for the Ministry of Finance, letters of credit for Iraqi ministries, and contracts administered by US Agencies.

The IAMB's terms of reference, initially approved in October 2003, enable the IAMB to oversee the completeness of deposits into the DFI, the management of the funds in the DFI and the use of DFI resources in the spending ministries, together with the power to complete special audits, which has proven useful. The IAMB is structured along the lines of international best practice models for audit oversight committees.

The IAMB, whose mandate was recently extended by the United Nations Security Council under resolution 1790 (2007), is now scheduled to conclude its oversight role of the financial position of the DFI, the principal repository for Iraq's oil-export receipts, no later than end-December 2008. The mandate of the IAMB was initially extended until December 31, 2005 under Security Council Resolution 1546 (2004), and was subsequently extended under resolution 1637 (2005) until December 2006 and under resolution 1723 (2006) until December 31, 2007. These resolutions recognized the significant role of the IAMB in helping the Government of Iraq to ensure that Iraq's resources are being used transparently and equitably for the benefit of the people of Iraq.

IAMB's Work in 2007

The IAMB welcomed the Iraqi oversight body—the Committee of Financial Experts (COFE)—that was established by the Council of Ministers in October 2006 to exercise oversight over petroleum revenues, working alongside the IAMB. Building on the financial management law, the oversight body is independent, competent and professional. COFE is intended to ensure the continued oversight of external audits and succeed the IAMB starting January 2008, at the conclusion of the IAMB's work. COFE is chaired by the President of the Board of Supreme Audit and includes two independent experts chosen by and reporting to the Council of Ministers with required public disclosure of their reports. COFE members attended the IAMB

¹ The IAMB has been in operation since May 2003 to oversee the DFI. The IAMB released its first summary report in December 2004 covering its operations for the period from the establishment of the DFI on May 22, 2003 until the dissolution of the Coalition Provisional Authority (CPA) on June 28, 2004. At the end of 2006, the IAMB released a second interim report with its comments and conclusions on its work for the period July 2004 to December 2006. This third interim report covers the IAMB's work during 2007.

meetings in 2007 and worked alongside the IAMB in the oversight of Iraq's oil export revenues. The IAMB and COFE will work closely together during 2008 and fully coordinate their work, with the IAMB placing increasing reliance upon the work of COFE while discharging its responsibilities under the UN Security Council Resolution. The IAMB began taking the steps necessary to ensure a smooth hand-over of its responsibilities to COFE at the end of 2008 in line with the expiration of the IAMB's mandate.

Under its mandate in 2007, the IAMB oversaw two audits of the DFI covering the period January to December 2006 and the interim results of the audit covering the period January to December 2007, conducted by international accounting firm Ernst & Young. These audits were undertaken on the ground in Iraq and under increasingly adverse security conditions. The audits cover (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) disbursements procedures for DFI resources to ensure that funds are used for the purposes intended.

The IAMB welcomed the progress made in 2007 to strengthen the financial and administration controls over the use of DFI resources in the spending ministries. The Iraqi representative to the IAMB, the President of the Board of Supreme Audit, and COFE all briefed the IAMB throughout 2007 on progress in implementing earlier IAMB recommendations and in strengthening the overall framework for public financial management in Iraq. The IAMB was encouraged by the initiative to follow-up on the many recommendations and by the initiative of the Council of Ministers to hold ministries accountable to strengthen internal controls. Some progress has been made with the establishment in 2007 of an Iraqi committee to address external audit management letters in cooperation with the Board of Supreme Audit. However, as of December 2007, there continued to be a lack of substantial progress in internal controls matters in Iraq. The IAMB found that further measures to strengthen the internal controls framework are necessary and overdue.

In 2007, the Board consistently continued to raise concerns about inadequate controls over Iraqi oil and other aspects of the DFI's operations:

- **The absence of oil metering.** The IAMB recommended in March 2004 the expeditious installation of a comprehensive oil metering system in Iraq in accordance with standard oil industry practices. Oil metering is a key factor to achieve financial transparency and accountability over oil resources in Iraq. 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 revenues, the 2007 audits identified large unreconciled differences regarding oil extraction, production and reported export sales. In the previous two reports, the IAMB welcomed the key steps taken to curtail smuggling and believes that a system of metering, as recommended earlier by the IAMB, would go a long way in improving overall control. Other audit reports in 2007 produced by the BSA, the U.S. Government Accountability Office (GAO) and the U.S. Special Inspector General for Iraq Reconstruction (SIGIR) also pointed to these weaknesses and confirmed the above concerns of the IAMB. It is imperative that progress be made to continue the path toward sound financial

governance to mitigate the current vulnerabilities to mismanagement and diversion of funds.

- **The use of barter transactions for certain oil sales.** The IAMB continues to be concerned that barter transactions are not accounted for in the DFI as required by UNSCR 1483. While some reduction in bartering occurred since 2004 following the allocation of Iraqi budget funds to import light petroleum products, the Iraqi State Oil Marketing Organization continued to undertake substantial bartering throughout 2007. The use of barter transactions makes it difficult to determine whether fair value has been received for Iraq's oil export revenues.
- **Persistent weak controls in the spending ministries.** The results of the audits in 2007 indicate that, while many efforts are being made sometimes at great personal sacrifice, the overall financial system of controls in place in the spending ministries, the US agencies in respect of outstanding commitments using DFI resources and the Iraqi administration of DFI resources remain deficient and financial management reforms need to be pursued further. The overall control system needs to be further improved to be sufficiently effective.
- **The external auditor, Ernst & Young, also raises ongoing concerns about the management of contracts of U.S. agencies.** The IAMB has noted that these contracts have been handed over to the BSA and welcomes further progress on this issue.

As in previous years, the IAMB worked through a virtual secretariat, with its operational work undertaken by staffs of the Board members. In line with the principle of full transparency, the IAMB continued in 2007 to disseminate documentation and information related to its operations through its website (www.iamb.info). The IAMB published all audit reports and related documents on its website and has issued press releases after its meetings and has posted the minutes of these meetings on its website.

Looking forward to 2008, the IAMB will continue to monitor controls over Iraqi oil export revenues, the use of those revenues in the spending ministries, and the installation of oil metering. Ernst & Young will finalize the 2007 audit of the DFI and will report its final findings to the IAMB. The IAMB will work closely with COFE on audits to be conducted in 2008, and to determine how the Board and its member organizations can advise the Government of Iraq on further strengthening the capacity over financial management in Iraq.

Conclusions

After four years of overseeing Iraq's oil export sales and the DFI, the IAMB concludes that:

- The IAMB has continued to fulfill its mandate to promote the objectives set forth in the UNSCR 1483 of ensuring that the DFI is used in a transparent manner for the benefit of the Iraqi people and that export sales of petroleum, petroleum products and natural gas are made consistent with prevailing international best practices.

- The IAMB questions the effectiveness of controls over the DFI expenditures and urges that these be improved. The Iraqi Government must exercise stronger financial and budgetary controls over oil export sales in a transparent way. Transparency in the collection, recording, investing and spending of oil revenues is of paramount importance in providing ongoing assurance that Iraqi oil resources are properly managed and spent, including publishing such information. The IAMB recognizes that the security situation in Iraq has contributed to weaknesses in the control framework over the DFI resources. The IAMB also recognizes that the Iraqi government has acted promptly and in good faith to develop the capacity to respond substantively to the recommendations coming out of the audit reports.
- The IAMB will continue its oversight role during 2008 and work closely with COFE. The IAMB urges COFE to continue its follow up on all audit recommendations, monitor their implementation and continue to report to the Council of Ministers on a six-monthly basis.