

To: IAMB Members

Below is a survey of the efforts to enumerate and follow up clearance of the observations raised in DFI audit reports from its inception in the year 2003 to end of the year 2007.

Follow up has been given priority by COFE ever since its establishment in April 2007 and a specialized team has been formed in the Board of Supreme Audit (BSA) to enumerate, investigate and review the responses received from the parties on which the observations have been raised, the object being to provide professional opinion thereon to COFE which would be:

Either – the observation is inaccurate and therefore requires no further action,  
Or – the observation is confirmed as correct and has been cleared by appropriate action.  
Or – the observation is accurate and is in the process of being cleared and subject to follow up.

We have two sets of audit reports, the first submitted by KPMG and covering the period from 2003 to mid 2005 and the second submitted by Ernst & Young and covering the period from mid 2005 to end of 2007. The two sets are widely different as the first set dealt with a period that followed the change of regime and witnessed difficult security situations.

Government institutions were re-emerging but with ruined information systems and weakened internal controls compounded by scarce technical personnel. Thus, the audit reports for that period were concise and general in their comments and focused on audit of the activities of the American agencies with limited coverage of the spending ministries. Most of the observations and comments were related to weaknesses in internal control systems including internal audits and support documentations, lack of centralized directives and clear works procedures, modest capabilities of staff engaged in accounting and financial works, and absence of job descriptions and demarcations of duties. These observations and comments were repeated in subsequent audit reports including those of E & Y.

The second set of reports submitted by E & Y were wider in scope and covered all spending ministries although the concentration was on ministries of oil, finance, trade, housing and construction in addition to the Central Bank of Iraq. The observations regarding information systems, internal controls and internal audits were repetitions of previous audit reports. Here below are statistics about the 2007 audit reports presented by E & Y as being the latest available which also encompassed audit observations in the reports of the previous years.

2007 reports of E & Y

<u>Subject</u>	<u>Risk Rating</u>				<u>New</u>	<u>Repetition</u>		<u>Total</u>
	<u>High</u>	<u>Medium</u>	<u>Low</u>	<u>Total</u>		<u>Cleared</u>	<u>Not yet</u>	
Contracts	58	36	11	105	37	28	40	105
Internal Controls	27	11	-	38	7	17	14	38
Others	38	33	24	95	22	19	54	95
Total	123	80	35	238	66	64	108	238
%	52%	33%	15%	100%	28%	26%	46%	100%

Total Observations	238	100%
Cleared as per E & Y reports	39	16%
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	199	84%
Observation about which BSA has reservations	24	10%
Observations cleared through follow up	25	11%
Remaining observations awaiting clearance	<hr/>	<hr/>
	150	63%

COFE and the follow up team are concentrating their efforts on clearing the outstanding observations which can be classified in three groups:

Group One: **Important observations concerning information systems and internal controls**

The BSA made an assessment of the information systems, internal organizations and internal controls in all the ministries and the assessment was carried out by specialized teams using internationally recognized criteria in this regard. The assessment covered job descriptions, internal controls, internal audit, control over performance, fixed and assets controls, procurement procedures, tendering and contracting. After completing this assignment, separate reports were sent to each ministry containing the results of the assessments and identifying the weaknesses. The reports were then discussed in detail with the inspectors general of each ministry and then the final outcome was contained in a comprehensive unified report sent to the council of ministers and posted on the BSA website.

COFE followed up the measures taken by the various ministries to improve their information systems and the most important measures were in respect of installing a

comprehensive metering system for oil which has now reached an advance stage with preparation for extending the metering to oil products at refineries, distribution centers and fuel stations. COFE also followed up the working of the information system for the ministry of finance installed by Bearing Point in co-operation with international financial institutions. The system which is now operational entailed setting up 32 accounting units reporting to a central unit in charge of supervision and verification of ongoing transactions. Further work is in progress on connecting the centrally financed spending units to the FMIS system. There are still technical reservations about the system as there are delays in outputs especially those relating to the State's final accounts. Other electronic systems are in progress such as a comprehensive unified payroll system including payrolls for pensioners, a social security assistance system, archives, personnel records and others. We consider that the efforts put in this regard are appropriate for this stage.

Group two: **Observation concerning contracts and tendering procedures**

The Coalition Provisional Authority (CPA) issued orders No. (4) of 2003 and No. (87) of 2004 containing detailed procedures which must be followed for contracting starting from announcement to tender and ending with award of contract. A contract department was established in the ministry of planning and a similar department/section was formed in each ministry in 2007. Previous contracting instructions based on FIDIC were re-activated and the ministry of planning issued the instructions No. (1) of the year 2008 containing methods and procedures for implementing contracts which provide flexibility as well as protection of public funds. Thus, this aspect of spending is well covered by appropriate procedures and instructions. Non-compliance due to negligence without loss of public funds is dealt with by reprimands. Other cases where material losses are incurred are dealt with wide legal and administrative proceedings.

Group Three: **Observation concerning the procurement and contracting office (PCO)**

Audit observations about the performance of the PCO have recurred in all audit reports during the years 2004 – 2007.

The main shortcomings noted were:

- Not maintaining proper books and records for the contracts.
- Not complying with contracting procedures.
- Insufficient supporting documents.
- Mistakes in information stored in database.

It is worth noting that many American inspectors' reports contained stronger reservations than those stated in the DFI audit reports. The justification as reported by the media at that time was the security situation which forced the PCO to follow exceptional methods of implementation. The BSA followed up this subject and asked for the handover of all contracts, records, files and all other documents related to the spending of DFI funds by the PCO for audit and investigation reserving the right of the State to claim compensation for any losses.

The PCO officially liquidated its operations on 31.12.2007, but the ministry of finance has not yet received the original records and documents referred to above. As the PCO did not provide the DFI auditors with substantial information required for the audits, the BSA requested the American inspector general to intervene and whose last letter dated 12/7/2007 stated that the PCO have been told to provide the information and would keep the BSA informed. Lastly, it is important to note that the DFI auditors during the years 2004 – 2007 concentrated their audits in Baghdad and in the Kurdistan province with virtually no coverage of the other (14) provinces. The reason given was security.

As the source of spending of the provincial administrations is the DFI, COFE have followed up the audit by the BSA of such spending.

Audit reports have been submitted to the concerned ministries, the council of minister and to parliament. To keep IAMB informed of this aspect of DFI spending, extracts from the various BSA audit reports will be communicated to the Board. Any observations raised in such reports will be followed up by the BSA until cleared. The role of COFE will be to deduce indications of general performance levels and give technical advice when needed.

In conclusion, COFE believes that there is still much need for improvement at administrative, supervisory and legal levels and hopes that the improvement in the security situation will speed up the progress towards achieving enhanced performances.

Committee of Financial Experts

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