

To : Chairman and Members of the International advisory and Monitoring Board (IAMB) on the Development fund for Iraq (DFI)

**Subject : Report By The Government of Iraq on
The Implementation of Recommendations
from the Previous Audits**

I survey below the basic frameworks of the Iraqi Government's program and it's Administrative policies to impose effective control and oversight of public funds and to identify financial and administrative malpractices, follow up their consequences and address them decisively .

1. Basic frameworks

1.1. To begin with, I wish to state that the draft permanent constitution which will be subject to a referendum on 15.10.2005 specifies the organizations which will be responsible for the audit and oversight of public funds. These organizations are the Board of Supreme Audit (BSA) and the Integrity Commission and both organizations report directly to the General Assembly which is the legislative body in the Country. Further, each Ministry has its organization chart , a specialized directorate headed by a General Inspector who reports directly to the Minister and whose duties are to audit and oversee public funds administered by the ministry whether receipts or disbursements . The Ministries' Inspector Generals have functional relationships with both the Board of Supreme Audit and the Integrity Commission.

In addition, the Financial Management Law which became effective from 1.7.2004 has established a comprehensive framework for the conduct of fiscal and budgetary policy in line with international best practices by setting a structured process for the formulation of the federal budget and a number of reporting requirements aimed at increasing the accountability and transparency of the budgeting process.

1.2. As far as oil revenues are concerned and after the end of IAMB at end of the year 2005, the Finance Management law of 2004 referred to above states in section 5 thereof the following:-

- Operational responsibility for the petroleum revenue account will be with the Minister of Finance reporting to the Council of Ministers which shall take advice from the Governor of the Central Bank and such other individuals as the Council may deem appropriate. The Council in its discretion may delegate responsibility for oversight of the operation of the petroleum revenue account

to a committee which shall be composed of such individuals as the Council may determine and shall include as a minimum, the Minister of finance, the Minister of Oil and the Governor of the Central Bank in an advisory capacity .

- The activities of the petroleum revenue account shall be subject to external audit conducted under the oversight of the Board of Supreme Audit.
- The Minister of Finance shall make publicly available details of the petroleum revenue account including opening and closing balance, underlying assets and summary of movements within three weeks of the end of each month. The Minister of Finance will authorize a quarterly review of the investment position and by the end of the month following the end of each quarter submit a report on the results of the review to the Council of Ministers or the committee mentioned above . The final report for each year will detail each investment and enumerate the changes in the portfolio over the year and will be made publicly available.

2. The Administrative Policies

The observations raised in KPMG 's reports (both, audit and internal control reports) may be summarized as follows to gather with the measures taken in respect of each observation :

2.1. Observations related to the Ministry of Finance

- 2.1.1. The external auditor has made the comment that there was no reconciliation between the Ministry of Finance and other Ministries regarding the amounts shown as transfers from the Ministry of Finance and the amounts shown by the other Ministries as receipts from the Ministry of Finance.**
This matter is now under control as a special department has been set up in the Ministry of Finance to monitor funds movements and reconcile corresponding Accounts . The Ministry of Finance has made it clear to all other Ministries that it will not authorize disbursements to Ministries unless reconciled statements of accounts are received.. The reconciliation appear to be working satisfactorily.

2.1.2. Closing of the accounts for the year 2004 and preparation of final accounts for the same year.

In fact this failure dates back to the years 2002 and 2003 as final accounts for the year 2002 were not presented due to complete collapse and destruction of the information system which was operative up to the change of regime in March /April 2003 in addition to the fact that the year 2003 was split into three periods Efforts have recently been intensified to bring accounts up to date and the situation is being followed up by the Ministry of Finance as well as by the International Monetary fund . The present status is :

The accounts for the year 2004 has been closed and the concerned department is awaiting completion of the audit for 2003 so that accounts and final financial statements for the year 2004 may be presented.

Trial balance up to 30.6.2005 has been extracted.

- 2.1.3.** KPMG report contained negative assessment of the budgeting system in Iraq. But it is to be recognized that 2005 budget was the first to be prepared under the new Financial Management Law of 2004 and was done in co-operation with the Ministry of Planning . The various Ministries were not familiar with the new requirement as laid down in meticulous details in the new Law . Work is currently on hand for preparing the budget for the year 2006 and detailed instructions have been issued by the Ministry of Finance and the Ministry of Planning to all other Ministries regarding how and when they should submit their estimates and the justifications therefore . It is to be further noted that , the Financial Management Law of 2004 and the draft permanent constitution which is yet to be ratified contain ideas that are yet to be translated into practical steps for implementation, especially as the process for preparing budget estimates go through the federal government, the governorates' councils and the various states councils . Clear instructions and training of personnel on preparing budgets and estimates is expected after ratification of the permanent constitution and the formation of a permanent elected government and the picture will be clearer in preparing the budget for the year 2007.
- 2.1.4.** KPMG report mentions that there are no unified instructions relating to implementation of the approved budget and rules governing disbursements of allocated funds, nor control and auditing procedures and authorities for expenditure . This matter has now been resolved and a booklet containing all relevant rules, regulations and instructions has been issued and circulated to all Ministries. (Accounting Instructions No.1)
- 2.1.5.** KPMG report has also referred to insufficient training for finance personnel. Training and development of finance personal is being intensified within and outside Iraq and is being accelerated to cover financial as well as administrative personnel. in all Ministries . In my view training and development efforts are progressing appropriately
- 2.1.6.** The auditor's report has commented that there are no comparisons between actual spending and allocations in the budget for the various Ministries and to ensues against overspending on allocations. This observation has been overcome through implementation of the procedures stated in Para 2.1.1 above. Further, a comparison between actual and budgeted expenditure is an essential requirement of the instructions for preparing final financial accounts for each year.

In relation to the same auditor's observation, the report states that expenditure supervised by American Agencies are not deducted from allocations to Ministries to which the related contracts belong . I think this is a valid observation and has been rectified by issuance of appropriate instructions .

2.1.7. KPMG report refers also to the amount of 1.4 billion U.S Dollars which has been transferal to Kurdistan Province since CPA's time and the amount is not spent up to the report's date.

The Ministry of Finance has considered this amount as part of budget allocations for Kurdistan Province for the year 2005. The amount shall be allocated to projects within the Province and to be decided upon within applicable procedures .

2.2. Observations related to the Ministry of Oil

2.2.1. The important observation which has been repeated in many reports is the lack of measuring meters for oil produced and oil exported.

As stated in my last report, the Ministry of Oil has issued invitations to tender for A complete measuring system for measurement and control over production, distribution within the country and export of oil. The Ministry has informed me that it has not been successful in obtaining appropriate responses even though the invitation has been repeated more than once. The lack of response is attributed to the security situation in the Country and the supplying parties are reluctant to make on the spot surveys of the requirements for a comprehensive measuring system . Lately an agreement has been reached with the American PCO for the project to be executed by the Americans (who can provide security) and financed from American donations. It is to be noted that lack of measuring meters applies to the production and exports from the southern fields only. Presently the system (ULLAGG) is being used at the southern ports of export and a special committee has been formed to read the meters and take measurements and this system has been used by representatives of the United Nations (SAYBOLT) since 1996.

As for production, distribution and exports from the northern fields there exist proper measurements at the Iraqi Turkish border as well as at the port of export in turkey.

2.2.2. As for the differences in fuel oil referred to in Para 8.2.1 of the relevant auditor's report. they are being investigated by the Board of supreme Audit in conjunction with the Ministry Of Oil. Appropriate measures will be taken in the light of the results of the ongoing investigations. But it is evident that a shortcoming exists which needs to be addressed.

2.2.3. SOMO has obtained the full amount of the bank guarantee (US\$ 1581378) referred to in Para 2.2.1 of the relevant auditor's report dealing with oil sales proceeds.

2.2.4. All oil sales are properly recorded in SOMO books including barter sales which were resorted to, to import needed fuel oils and electricity . Electricity power plants have been badly affected by terrorists acts and local refineries cannot supply all the fuel oils needed to operate the power plants.

3. Effectiveness of Internal Controls

3.1. With the object of gathering all audit observations and comments raised in the various audits / investigations undertaken by different parties a special department has been set up within the Board of Supreme Audit to which all audit and investigation reports have been referred and in particular, the following reports:-

- KPMG reports on audits of DFI since its inception.
 - Inspector General's report for Iraq reconstruction (SIGIR)
 - DCAA report
 - E&Y report on oil for food program.
 - Reports of the U.N.'s special investigator into the oil for food program.
- The new department is assigned to follow the measures taken or to be taken To recover losses (from Iraqi and foreign entities) due to malpractices and negligence and to avoid recurrence of such practices or prevent them completely.

3.2. The Board of Supreme Audit is continuing with its audit and investigative work with emphasis on Ministries that were not covered by KPMG audits such as Ministry of Interior and Ministry of Defense .BSA's audit programs cover all Ministries and their checking is much wider in coverage than that carried out by KPMG. A comprehensive unified report covering all Ministries and other Government departments will in due course be submitted to the General assembly (Parliament).

3.3. The latest report of the Integrity Commission on its activities since its establishment and in relation to control over public funds the Commission has detected (1500) cases of financial and administrative corruptions.1100 cases have been investigated of which 450 cases have been referred to courts for issuance of appropriate punishments according to the Law .

3.4. As for KPMG's comment that Government books of accounts are maintained manually and that there is confusion in the classification of the Government budget, I stated in my earlier report that Bearing point has been contracted with to address

this situation, and the information system recommended by bearing point is now operative in the Ministry of Finance and the budget for 2006 is now being prepared according to the classifications suggested by B. P.

DFI account are now computer produced and summary statements are presented to the Minister of Finance on a regular basis .

3.5.The Board of Supreme Audit has submitted a report on the outcome of the follow up of the various Ministries, measures to deal with KPMG's observations and comments. Some have been mentioned above but others are being vigorously pursued by the new department within the BSA referred to in Para 3.1. above.

4. Payments under contracts supervised by American Agencies

These are contracts concluded by CPA but were unfinished when sovereignty was reverted to the Iraqi Government . Many of the auditor's comments related to documentation and incomplete information and reservations about some payments. The report also states that the PCO has assigned to an American Agency the task of ensuring that all contracts funded from the DFI have complete supporting documentation and this task is expected to be completed by 30.12.2005. The report mentions that there are ten cases of payments being investigated and will be followed up.

Generally, the Ministry of Finance awaits the results of these measures and will coordinate efforts with the PCO about further actions to be taken if any in respect of the results of the audits / investigations.

In addition to the foregoing , the procedure currently applied is that no payment is to be made under these contracts unless the " Employer " (usually the concerned ministry) approves it in accordance with the terms of the contract.

**Iraq Representative
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