

International Advisory and Monitoring Board on the Development Fund for Iraq

Press Release
December 18, 2006

Statement by the International Advisory and Monitoring Board on the Development Fund for Iraq

The International Advisory and Monitoring Board (IAMB) on the Development Fund for Iraq (DFI) met in New York on December 11, 2006 and issued the following statement:

"The International Advisory and Monitoring Board (IAMB) has been in operation since May 2003 to oversee the Development Fund for Iraq (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. We now present our second interim report with the IAMB's comments and conclusions on our work until December 2006.

"The primary responsibility of the IAMB is to promote the objectives set forth in 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. In the period from inception in 2003 to end-June 2006 the DFI received \$68.8 billion from the proceeds of Iraqi oil export sales, balances from the UN oil-for-food program and frozen Iraqi funds, and disbursed \$59.6 billion for the Ministry of Finance, letters of credit for Iraqi ministries, and contracts administered by US Agencies.

"The Board has consistently raised concerns about inadequate controls over Iraqi oil and other aspects of the DFI's operations, originally with the US Government and more recently with the Government of Iraq. The IAMB was one of the first to raise these issues and alert others about these practices:

- **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. Oil production and the related oil export sales have dropped since early 2003, but are gradually rising again in 2006. As an interim step, the IAMB welcomed steps taken by the CPA to curtail smuggling. Some metering has since been installed at oil terminals, but there continues to be no metering in the oil fields. While the Iraqi Government supports oil metering, progress has been slow.
- **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. The State Oil Marketing Organization recorded barter transactions of \$689 million between May 2003 and June 2006. Some bartering of oil for electricity with a neighboring country continues. 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.** Recent audits note that the DFI overall control systems need to be strengthened and continue to be critical of the financial and accounting control systems in place in the spending ministries, the US agencies in respect of outstanding commitments using DFI resources and the Iraqi administration of DFI resources. The overall control system needs to be further improved to be sufficiently effective.
- **The use of non-competitive bidding procedures by the CPA for some contracts funded from the DFI.** The IAMB recommended that competitive bidding procedures be used and welcomed steps taken by the CPA to limit future single-sourced contracts to exceptional circumstances. The IAMB continues to question the reasonableness of some of the costs charged and the adequacy of the administration of contracts. While only relatively small exceptions were noted in the recent follow-up special audits, including of KBR contracts, the IAMB noted exceptionally high transportation costs charged in providing humanitarian fuel supplies to Iraq, in some cases as much as 86 percent of the total contract costs and resulting in a final cost of nearly \$7 per gallon. The IAMB observed that the US Special Inspector General for Iraq Reconstruction (SIGIR) has also noted high levels of overhead costs in other contracts. In view of the findings of the special audits, the IAMB recommended that the Iraqi Government seek resolution with the US Government concerning the use of resources of the DFI which might be in contradiction with UNSCR 1483.

"Under its mandate the IAMB has overseen six audits of the DFI conducted by international accounting firms, KPMG and 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) the disbursements procedures for DFI resources to ensure that funds are used for the purposes intended.

"The IAMB welcomes the progress being made in strengthening the financial and administration controls over the use of DFI resources in the spending ministries, but further measures are necessary. The Iraqi representative, the President of the Board of Supreme Audit, and SIGIR have all briefed IAMB on progress in implementing earlier IAMB recommendations and in strengthening the overall framework for public financial management in Iraq. The IAMB took note of SIGIR findings regarding oversight of DFI funds provided to Iraqi ministries and US reconstruction projects that were similar to those identified by the DFI auditors. The Iraqi financial management law contains provisions on accountability and audit oversight, including publication of financial reports of oil revenues. Other steps reported to the IAMB include the establishment of an inspector general directorate within each ministry; steps to strengthen control at the Ministry of Oil and the spending ministries; the adoption of rules and regulations regarding disbursements of allocated funds; and the training of finance personnel. However, progress is slow and rebuilding the financial infrastructure will take some time. The IAMB continues to urge the Government of Iraq to take concrete steps to address the audit findings and recommendations to ensure that oil resources are better protected.

"The IAMB has also overseen special audits of sole sourced contracts. Earlier Defense Contract Audit Agency audit reports indicated overcharges and questioned costs in excess of \$200 million on these contracts. The US Government commissioned these audits with long delays. The audits have now been completed and all sole-sourced contracts in excess of \$5 million awarded by the CPA have been the subject of a special audit. The IAMB concluded that contracts using DFI resources for an amount of \$1.5 billion were in line with US Government procurement practices and were mostly supported by proper documentation, with a few exceptions. The auditors reported that in their opinion the settlements between KBR and the US Army Corps of Engineers were reasonable.

"The IAMB welcomes the establishment of an Iraqi oversight body—the Committee of Financial Experts (COFE)—by the Council of Ministers in October 2006 to exercise ongoing oversight over petroleum revenues. The COFE will be chaired by the President of the Board of Supreme Audit and include two independent experts to be chosen by and reporting to the Council of Ministers with required public disclosure of their reports. The IAMB has made recommendations on the modalities of the oversight body to the Government of Iraq. Building on the financial management law, the successor oversight body will be independent, competent and professional, to ensure the continued oversight of external audits and to succeed the IAMB at the conclusion of its work. The IAMB is already taking steps to ensure a smooth hand-over of responsibilities and we expect that the COFE members will attend the remaining IAMB meetings and work alongside the IAMB in the oversight of Iraq's oil export revenues.

"Looking forward to 2007, 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 has already been appointed to complete the 2006 audit of the DFI and will report its final findings to the IAMB. The IAMB will 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 three years of overseeing Iraq's oil export sales and the DFI, the IAMB can conclude that:

- The IAMB continues to fulfill its mandate of promoting 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 Iraqi Government must exercise strong 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 effectiveness and control over the DFI expenditures is questioned and controls need to be improved. This is in part due to the security situation and the largely ineffective contracting procedures. The IAMB continues to question the reasonableness of the costs incurred under sole-sourced contracts and the adequacy of the administration of contracts and has recommended that the Iraqi Government seek resolution with the US Government on the use of resources that might be in contradiction with UNSCR 1483.
- The IAMB looks forward to continuing to work closely with the successor Iraqi oversight body and arrangements are in place to ensure a smooth transition when the mandate of the IAMB expires. The IAMB will continue its oversight role in 2007 and will advise the Iraqi Government on the further strengthening of financial management. The Iraqi oversight body should continue to follow up on the IAMB's findings and recommendations to ensure that oil resources are better protected.

Background on IAMB

"The IAMB, whose mandate was recently extended by the United Nations Security Council, 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 2007. The mandate of the IAMB was initially extended until December 31, 2006 under UNSCR 1637 and further extended until December 31, 2007 under UNSCR 1723. This resolution 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.

"The IAMB's terms of reference, approved in October 2003, provide the IAMB mandate 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 initially comprised four members representing the Executive Heads of the Arab Fund for Economic and Social Development, the International Monetary Fund, the United Nations, and the World Bank. A fifth member was designated by the Government of Iraq in June 2004. Until June 28, 2004 disbursements from the DFI were directed by the CPA in consultation with the Iraqi interim administration. The mandate and membership of the IAMB was initially extended by UNSCR 1546 and resources of the DFI were controlled by the Government of Iraq from June 2004.

"The security situation continues to prevent the establishment of the IAMB secretariat in Baghdad as provided in the terms of reference. As an alternative, a virtual secretariat was established, with the operational work of the IAMB being undertaken by staffs of the Board members. In line with the principle of full transparency, the IAMB established a website (www.iamb.info) to disseminate documentation and information related to its operations. The IAMB has published all audit reports and related documents on its website and has issued press releases after each meeting.

"The next meeting of the IAMB is tentatively scheduled for May 2007."