

KPMG

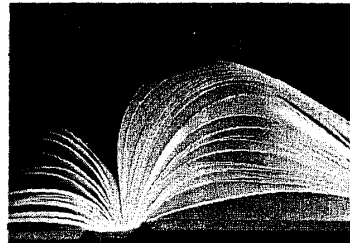
Interim Update - External Audit Services to the Development Fund for Iraq (DFI)

Ref: DABV01-04-R-0015

Coalition Provisional Authority / International Advisory
and Monitoring Board

Agenda

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1. Executive Summary

KPMG has been selected by the CPA and approved by the IAMB as the external auditor of the DFI, in accordance with UNSCR 1483.

Engagement letters clarifying the scope and responsibilities of all parties are still in draft form.

KPMG has established its base of operations within the CPA since the kick-off meeting, and has commenced audit procedures at the CPA and the Iraqi Ministries (the ministries). While we have kicked off, we have encountered problems that may prevent us from reporting on the June 30 reporting deadline.

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2. Status of the Audit

- **KPMG has commenced procedures including:**
 - the CPA (over disbursements for PRB, CERP & RRRP items and the DFI bank accounts).
 - SOMO (over export sales and barter transactions).
- **Matters pending include:**
 - Access to the ministries and documents thereof, as required to undertake our procedures.
 - Answer to our request for a meeting with the Technical Department of the Ministry of Oil, to discuss the global reconciliation for oil extractions to oil exports.
 - Response to our request for confirmations from the UN and the FRBNY.
 - Answer to our request for information from the US Navy (movements of oil carrying vessels) and the SOC (shipping documents detailing quantities loaded onto ships).

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3. Co-operation from the CPA and Ministries

KPMG has encountered resistance from CPA staff (including the contracting unit) regarding the submission of information required to complete our procedures. Staff have indicated to KPMG that their workload is already excessive, and that cooperation with KPMG's undertakings is given a low priority.

Co-operation with the core team of Colonel Engelbrektsson, Colonel Davis and Edward Terek, by contrast, has been exemplary. KPMG has concerns that with Colonel Engelbrektsson's imminent rotation on 7 June 2004, that this cooperation will be continued by his replacement.

KPMG's first visit to the ministries was repeatedly postponed, and KPMG's procedures at the ministry level have not commenced except for one meeting with the Ministry of Finance.

Additionally, KPMG has encountered bureaucratic hurdles in obtaining the required identification passes to allow passage within the 'Green Zone'.

The issues noted above have been discussed with Colonel Engelbrektsson, and KPMG has been informed that all necessary steps will be taken in order to ensure full cooperation with our procedures, to allow us to meet the June 30 reporting deadline.

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4. Accounting Framework of the DFI

- The accounting system consists of spreadsheets and pivot tables maintained by a single accountant. This lack of a double entry system makes the accounting records much more prone to error.
- The system was designed to capture transactions on a cash basis only, and has not been given functionality to capture accruals and prepayments.
- The system has a limitation in the recording of funds advanced for certain projects (notably the Commander's Emergency Response Program [CERP] and the Rapid Regional Response Program [RRRP]). For these items, funds are allocated as 'spent' until the funds or receipts representing the fund value are returned to the CPA Comptroller's office.
- Additionally, when the receipts for the above programs are returned, they are not recorded on an individual basis within the DFI's accounting records, but rather as a 'block' payment for their entire value. While these payments are supported by boxes of receipts, this record keeping greatly diminishes the transparency of the expenditures made, and leaves the DFI open to fraudulent acts.

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5. Other Control Issues at the DFI

- The extremely high levels of staff rotation (the Comptroller's office has had 4 different heads in the last 12 months) as lead to inconsistencies in the controls process. Additionally, we were informed that when the Comptroller's office was founded that controls were less stringent than current practice.
- While the CPA is responsible for the DFI's financial reporting, the CPA does not have effective controls over the ministries spending of their individually allocated budgets, whether the funds are direct from the CPA or via the Ministry of Finance.
- The DFI is not a business, but control needs to be exerted over various Iraqi companies in the oil sector, numerous departments within the CPA, the IGC, the ministries. While in certain respects the controls implemented may be sufficient, for others the controls appear to be inadequate.
- The scope established for the CPA's internal audit function does not include the ministries and their expenditures.
- The CPA engaged in sole source contracts during the period from inception to 31 December 2003. To date, KPMG has not been given access to special audit reports by the CPA that have been undertaken on these contracts.

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6. Potential Audit Adjustments

Potential adjustments required under the accruals basis include:

(In millions of USD)	Asset/ (Liability)
1. Cash due from the UN Oil for Food Program (cash received in 2004)	2,500
2. Additional cash due from UN Oil for Food Program (not received to date)	p.m.
3. 2003 SOMO crude oil export sales with cash received in 2004	1,154
4. Barter transactions for export of fuel oil for imported oil products	110
5. Accrued interest on DFI bank accounts (T-Bills and overnight deposits)	p.m.
6. Advances made for CERP and RRRP programs	96
7. Advance returned in January	25
8. Cash received from the ministries to make wire transfers on their behalf	(30)
9. Accrual for 2003 expenditures (electricity imports from Turkey etc)	(4)
10. Audit fees	(2)

p.m. – pour memoire – additional work required to finalize these adjustments

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7. Oil Sales Statistics

Total export sales of crude oil made by SOMO for the period from post hostilities to 31 December 2003:

	USD	Barrels	Av. Price
Total export sales of crude oil	5,076,633,501	198,242,690	25.608
Lowest sales price			21.826
Highest sales price			27.757
Comprised of:			
25 International Companies	4,797,635,181	187,467,244	25.592
3 Oil Traders	278,998,320	10,775,446	25.892
Comprised of:			
Basrah crude	4,882,837,972	190,503,173	25.631
North crude	193,795,529	7,739,517	25.040
Cash Receipts for 2003 sales:			
Cash received by the DFI in 2003	3,922,390,870		
Cash received by the DFI in 2004	1,154,242,435		
Number of transactions:	136		
Transactions tested by KPMG:	75		

(Source: Summarized by KPMG from SOMO sales records and DFI bank statements)

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8. SOMO Control Issues

■ Tenders and Contracts

- Terms and conditions of the standard contracts are not always comprehensive and may not always clearly define the responsibilities and liabilities of contracting parties.
- Tendering and contracting decisions are not documented to ensure transparency of sales decisions. Additionally, where the highest bidder is not awarded the contract, no note is prepared justifying the award of the contract to another bidder.
- Contracts are silent regarding demurrage costs that may arise.
- No up-to-date list of authorized signatories is maintained.

■ Barter Transactions

- A substantial part of the barter transactions are not recorded in terms of quantity and value in the accounting records. The only record of transactions is an independent database, derived from verbal confirmations gained by SOMO staff.
- SOMO prepares documentation (sales invoice and purchase invoices) for both itself and the other party in the barter transaction, without any formal reconciliation procedures between the parties.

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8. SOMO Control Issues – cont.

▪ Computer system

- Currently there is no integrated computer system between SOMO departments to record oil product import and export transactions. Such a system should hold information including contractual types and volumes, volumes of imported/exported products (both up to date, and confirmed by the distribution and pipeline companies) and the net debit/credit position with suppliers.

▪ Other points

- Imported oil product are only verified on a random basis for quality or quantity, against contractual specifications.

- No general ledger entries have been maintained since post hostilities. Accordingly, no financial statements have been prepared for the periods ended 2003 or 2004.

- The SOMO Internal Audit Department does not have access to export sales contracts, but rather control only administrative expenses.

- No centralized server based backup procedures exist.

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9. The Way Forward

▪ Finalization of our engagement letters.

▪ Decision on cash basis vs. accruals basis to taken by the IAMB and the CPA.

▪ Decision on the special audit of the sole source contracts.

▪ Either the CPA and the IAMB act to ensure that KPMG has access and assistance in the completion of our undertakings, or the reporting deadline is moved backwards.

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10.1 Summary of Balance Sheet

Financial information of the DFI as of 31 December 2003, prepared on a cash basis, is as follows (in millions of US dollar):

Cash inflow (since inception):	
▪ Transfer of surplus funds from Oil for Food	5,600
▪ Proceeds from oil exports (note 1)	3,726
▪ Seized assets	742
▪ Other	<u>265</u>
	<u>10,253</u>
Cash outflow (since inception):	
▪ Ministry budgets	(1,446)
▪ Payment for projects	(462)
▪ Other	<u>(11)</u>
	<u>(1,919)</u>
Cash and cash equivalents	<u>8,334</u>

Note 1- 2003 SOMO sales less cash received by the DFI in 2004, less 5% paid to Compensation Fund

Source: CPA Database
Source: 10.2 - CPA Database

Thank You

Summary of DFI Disbursements

10.2

Job code	Description	Allocated	Deposited	Paid in 2003	Outstanding
373	Ministry of Finance - Iraqi Banknote Purchase	119,170,000	-	(116,592,500)	2,577,500
440	Ministry of Finance - Iraqi Banknote Exchange	47,950,000	-	(31,154,245)	16,795,755
537	Ministry of Finance - Iraqi Currency Exchange	9,000,000	-	(340,000)	8,660,000
530	Ministry of Finance - FY 03 Supplemental: Oil for Food in North	106,400,000	-	(13,461,800)	92,938,200
432	Ministry of Electricity - Generation of Electrical Power (4400MW)	25,000,000	-	(4,919,055)	20,080,945
499	Ministry of Electricity - Purchase of Power from Turkey	16,381,750	-	(11,392,602)	4,989,148
399	Ministry of Oil - Restore Oil Infrastructure	300,000,000	-	(1,130,000)	298,870,000
369	Ministry of Oil - Security Contract	45,000,000	-	(12,559,809)	32,440,191
446A	Ministry of Oil, SOMO - Import of petroleum products	25,000,000	-	(13,417,109)	11,582,891
431	Ministry of Oil - Communications	349,942	-	(315,491)	34,451
521	Ministry of Housing and Construction Government of Iraq - Building Security	420,045	-	(569,320)	(149,275)
573	Ministry of Water Resources - Public works	26,116	-	(26,116)	-
518	US Army Corps of Engineers CPA Electrical Priorities for TF Restore Iraqi Electricity (RIE)	756,000,000	-	(4,100,000)	751,900,000
576	Comptrollers Office - Commander Emergency Response Program (CERP) Funds	160,000,000	-	(93,000,000)	67,000,000
225	Comptrollers Office - Iraqi Trade Facility	5,000,000	-	(1,100,000)	3,900,000
448	National Security & Defense - Equipment for Iraqi Civil Defense Corp	1,277,748	-	(1,277,748)	-
265	CMAATT- National Iraqi Army Weapons	5,950,000	-	(2,832,000)	3,118,000
489	Strategic Communications - Printing of new Salary Scale materials	361,000	-	(361,000)	-
no number	No PRB number allocated. Money returned to DFI in 2004 in whole amount as it was not spent	-	-	(25,000,000)	(25,000,000)
Various	Other PRB projects approved in 2003, but not commenced	-	-	-	-
MSC016	Donation from Clear Channel. Disbursement to the Ministry of Culture	-	20,000	(20,000)	-
RRRPN	Regional Risk Response Program - North Police Equipment for the City of Samarra; other	23,952,262	-	(2,801,500)	21,150,762
WFP	UN World Food Program - Wheat purchase	-	120,000,000	(125,400,000)	(5,400,000)
	Total PRB and Other Projects	1,647,238,863	120,020,000	(461,770,295)	1,305,488,568
Budget0310	Payment to the Ministry of Finance, October 2003 budget	433,000,000	-	(433,000,000)	-
Budget0311	Payment to the Ministry of Finance, November 2003 budget	392,950,000	-	(392,950,000)	-
Budget0312	Payment to the Ministry of Finance, December 2003 budget	555,051,050	-	(555,051,050)	-
Budget0312	L/C payments on behalf of the Ministry of Finance, December 2003 budget	65,235,663	-	(65,235,663)	-
	Total MOF	1,446,236,713	-	(1,446,236,713)	-
MOE/CBI	To date, no information was provided to KPMG for this disbursement	-	30,000,000	(120,524)	29,879,476
MOI/CBI	Payments by the CPA on behalf of the Ministry of Interior for supplies for the Iraqi police	-	10,704,471	(10,421,771)	282,700
	Total Ministries	-	40,704,471	(10,542,295)	30,162,176
	Total	3,093,475,576	160,724,471	(1,918,549,303)	1,335,650,744

Source: CPA Database

Allocated: Initial budget for the Ministry/PRB

Deposited: Monies deposited by the Ministry in order for the DFI to make wire transactions on the Ministry's behalf