



REVENUE WATCH

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Auditors Find Poor Practices in Management of Iraqi Oil Revenues

A preliminary audit of the Coalition Provisional Authority's (CPA) management of Iraqi oil revenues and the Iraqi State Oil Marketing Organization's (SOMO) export sales and barter transactions reveals serious accounting weaknesses and opportunities for corruption. The audit is being carried out by KPMG for the International Advisory and Monitoring Board and is due to be made public in mid-July.

Iraq Revenue Watch has called attention to the lack of transparency in the CPA's management of Iraq's oil revenues.¹ KPMG's preliminary findings indicate that the CPA has provided a poor example to its successors on how to manage oil revenues transparently.

A copy of KPMG's preliminary findings was provided to Iraq Revenue Watch and highlights the following concerns:

- ▶ *Lack of cooperation.* KPMG reported serious problems of access and lack of cooperation that could prevent the completion of their work by the June 30th deadline. It reports resistance from CPA staff who have indicated that their workload is already excessive and that cooperation with the auditors is a low priority. They note that although cooperation with the audit team led by Colonel Engelbrektsson, Deputy Comptroller of the U.S. Defense Logistics Agency has been exemplary, they are concerned that with the Colonel's rotation on June 7, this cooperation would diminish.

KPMG's visits to Iraqi ministries have also been hampered and they have succeeded in meeting with only one ministry. They have also encountered bureaucratic hurdles in obtaining the passes needed to enter the "green zone" where CPA and government offices are based.

The auditors also regret the lack of information provided to them about sole source contracts from the DFI. These contracts are among the most controversial of the DFI's operations, and the IAMB raised concerns about them in recent meetings. KPMG states that they have not been given access to audits conducted by the CPA of these sole source contracts.

- ▶ *Poor accounting for the Development Fund for Iraq (DFI).* KPMG noted a number of weaknesses in the CPA's accounting practices for the DFI, which result in inaccuracies and are prone to error. The report notes that the DFI's accounting lacks a double entry system and consists solely of spreadsheets and tables maintained by a single accountant, making the records prone to error. Another weakness is that only cash transactions are recorded, to the exclusion of accruals and prepayments. This obscures obligations against the DFI that have not yet been paid. Moreover, the high rate of turnover at the Comptroller's office has led to inconsistencies in accounting practices.

KPMG also notes the poor reporting around dispersals made by the Commander's Emergency Response Program (CERP) and the Rapid Regional Response Program (RRRP). These are highly discretionary programs that allow reconstruction officials based in the regions to use their judgment in giving out Iraqi oil dollars to maintain peace and pay for urgently needed repairs. Transfers to CERP and RRRP are not itemized, which according to the auditors, "greatly diminishes the transparency of the expenditures made and leaves the DFI open to fraudulent acts."

The report also notes that the CPA does not have "effective controls over the ministries spending of their individually allocated budgets."

- ▶ *Poor record keeping on oil sales.* KPMG found critical deficiencies in SOMO's records on oil sales and barter transactions. They note that the standard contracts used by SOMO do not thoroughly define terms and conditions, leaving ambiguity surrounding the obligations and liabilities of contracting parties. For example, demurrage costs, which are the costs that shippers must pay for delays in loading or unloading cargo at a port, are not mentioned in SOMO's contracts.

Decisions on tenders or contracts are not documented, which undermines transparency. When contracts are not awarded to the highest bidder, there is no explanatory note prepared to justify the decision.

KPMG also finds poor record-keeping about barter transactions. Key data about quantity and value are missing, and the only database is one based on verbal reports from staff.

Because it has not maintained its general ledgers, SOMO has not prepared any financial statements for 2003 and 2004. SOMO's audit department fails to provide adequate oversight because it does not have access to sales contracts. It only has the authority to oversee administrative expenses.

KPMG warns that unless the CPA acts to improve the auditors' access to needed documents and staff, KPMG may not be able to meet its reporting deadline.

The sloppy record-keeping maintained by the CPA and SOMO, and the absence of oversight within the Iraqi ministries has created opportunities for corruption to flourish under the CPA. In order to put a stop to the cronyism and corruption that prevailed under Saddam Hussein, the interim government must take steps to correct the accounting weaknesses identified by the IAMB's auditors.

Notes

1. Keeping Secrets: America and Iraq's Public Finances. Iraq Revenue Watch, October 2003.
<http://www.iraqrevenuewatch.org/reports/101403>

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Iraq Revenue Watch monitors Iraq's oil industry to ensure that it is managed with the highest standards of transparency and that the benefits of national oil wealth flow to the people of Iraq. Iraq Revenue Watch complements existing Open Society Institute initiatives that monitor revenues produced by the extractive industries.

In many parts of the world, the lack of proper stewardship over oil resources has resulted in corruption, the continued impoverishment of populations, and abuses of political power. By prompting governments to tackle these problems early, the Open Society Institute hopes to help Iraq avoid this plight.

The Open Society Institute currently supports a recently launched initiative, Caspian Revenue Watch, which monitors the development of oil production in the Caspian basin. The goal is to promote transparency, accountability, and public oversight in the management of oil and natural gas revenues.

Iraq faces even greater challenges than the Caspian region. If Iraq is to become an open, democratic society it will need to develop transparent accountable institutions for ensuring honest management of oil revenues.

There is an urgent need for Iraq Revenue Watch given the current occupied status of the country. The Coalition Provisional Authority and the Iraqi Governing Council should establish rules that ensure complete transparency regarding Iraqi oil revenues. So doing will foster a stable, democratic Iraq, and will protect the Coalition Provisional Authority from charges of misappropriation during this period of trusteeship over Iraq's reconstruction.

The **Open Society Institute**, a private operating and grantmaking foundation based in New York City, implements a range of initiatives throughout the world to promote open society by shaping government policy and supporting education, media, public health, and human and women's rights, as well as social, legal, and economic reform.

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