



Racing the Deadline: The Rush to Account for Iraq's Public Funds

After months of diplomatic wrangling and delays, the International Advisory and Monitoring Board (IAMB) has finally begun to function.¹ Yet under its current mandate, the IAMB has less than three months to account for \$7.3 billion of Development Fund for Iraq (DFI) expenditures made by the U.S. led Coalition Provisional Authority (CPA). Unless the Board is able to work beyond June 30, there is no way it can provide an accurate and public accounting for so much money. The delay and absence of IAMB oversight of the CPA is particularly worrying in light of recent reports by inspector generals at the Pentagon, USAID, and the General Accounting Office noting pervasive violations of contracting procedures in the allocation of U.S. and Iraqi funds for the reconstruction of Iraq.²

A second challenge facing the IAMB is the need for it to increase Iraqi participation in its general operations and decision making processes to ensure continuity. At its March 2004 meeting, the IAMB rejected a proposal to amend the Board's terms of reference to give Iraqi observers voting rights. The exclusion of Iraqis from membership in the IAMB risks rejection of the IAMB's findings and methodology by an Iraqi government once the IAMB is dissolved.

An examination of the minutes of IAMB meetings reveals gaps in the CPA's management of Iraq's oil, and the continuing exclusion of Iraqis in the oversight of their oil revenues. These minutes also raise concerns about how the work of the IAMB will continue after the handover of sovereignty to Iraq in June.

The following report discusses the process by which the IAMB was established, examines the board's work to date and considers the major challenges and opportunities it faces in reviewing Coalition management of Iraqi revenues.

Background

Both the DFI and the IAMB were established under UN Security Council Resolution 1483 in May 2003. Iraq's oil revenues, along with all Saddam-era assets seized abroad and leftover Oil for Food program funds are held by the DFI. To ensure that DFI funds are managed transparently and in the Iraqi people's best interest, Resolution 1483 mandated the creation of the IAMB to monitor CPA management of Iraq's revenues until the country regained sovereignty.³

It took months of intense wrangling between the members comprising the IAMB—the World Bank, the International Monetary Fund, the United Nations, and the Arab Development Fund—and the CPA to finally agree on terms of reference for the IAMB's establishment. According to one member of the UN Security Council interviewed by Iraq Revenue Watch, original terms of reference drafted in Washington limited the IAMB's role to auditing the auditors—ensuring that audits conducted by an external auditor met international standards.⁴

This was unacceptable to the institutions comprising the IAMB, who insisted on greater inspection authority. The disagreement resulted in a five-month stalemate during which the CPA spent approximately \$3.9 billion in Iraqi oil revenue with no independent auditing of those expenditures. The stalemate was only broken on the eve of the Madrid donors' conference in October 2003, when, eager to attract donor support to the hefty task of reconstructing Iraq, the United States conceded to the terms of reference that the IAMB's members insisted upon.

The enlarged authority under the IAMB's final *Terms of Reference*⁵ allows it to:

- ▶ monitor the export of oil and gas from Iraq to ensure that these sales are consistent with international market best prices;
- ▶ audit the receipts from oil sales held by the DFI in the Federal Reserve Bank of New York;
- ▶ audit all inflows, outflows, investments, and liabilities of the DFI;
- ▶ review whether transfers from the DFI were used “for the purposes for which they were disbursed”;
- ▶ conduct “special audits” to determine whether other aspects of CPA's management are consistent with UN Security Council Resolution 1483.

Despite the IAMB's expanded mandate victory, two more months passed before the board met for the first time in December 2003 and another two months passed before the IAMB moved past procedural issues to a more substantive meeting in February 2004. A tender to select an external auditor required receipt of proposals by February 18. It took another month to approve

an auditor. These delays are particularly worrying given the IAMB's short lifespan. The body will dissolve once an "internationally recognized, representative government of Iraq is properly constituted," which is scheduled to happen on June 30th of this year, when the CPA hands sovereignty to Iraq and dissolves. Its broad auditing mandate and its short lifespan make the IAMB's task particularly daunting.

It is worth noting that although the IAMB has a broad mandate, it has no power to sanction the Coalition Provisional Authority for financial mismanagement, nor compel it to cooperate in the IAMB's investigations. The only sanction will be from the court of world opinion; hence, it will be important for the press to focus its attention on the IAMB's findings. Judging from meeting minutes, the CPA appears to be cooperative in the IAMB's inquiries to date.

Following the Money Trail

The IAMB plans to conduct two audits. The first will cover the period from the DFI's inception to December 2003. A second audit will cover January – June 30, 2004, when the CPA is scheduled to hand over authority to an interim government and dissolve. The auditor's reports will be made available on the IAMB website within 30 days of being finalized by the IAMB.

Under the Coalition Provisional Authority, Iraq has exported just over \$6.9 billion in crude oil since the fall of Saddam Hussein's government in March 2003.⁶ Since March 2003, the United States, other countries, and the Bank for International Settlements have transferred an estimated \$2.5 billion in frozen Saddam-era assets to the DFI, and another \$1.3 billion has been found inside Iraq and presumably deposited in the DFI. The UN Oil for Food program transferred over \$4 billion to the DFI as of December 2003.

Substantial flows have also gone out of the DFI. To date, the DFI has spent over \$6.9 billion⁷ on infrastructure, administration, security and other projects.⁸ Recommendations on DFI spending are made by a Coalition dominated Program Review Board⁹, and presented to the administrator, Paul Bremer, for approval. After heavy criticism, the CPA began to publish information about flows to and from the DFI, although this reporting is still overly general. Belatedly, the Program Review Board also began to report the sources of funds that are to be used to pay for the expenditures it approves. Since the Program Review Board is able to draw from numerous sources of funding—U.S. appropriations, the Iraqi budget, the DFI—the absence of details about the source of funds led to confusion about when and how Iraqi oil money was being used. This lack of transparency created the potential for abuse, as occurred when Iraqi revenues from the DFI were used to remunerate Halliburton, after the U.S. Congress forbid its appropriations from being used to pay for contracts—such as Halliburton's—that were not competitively bid.¹⁰

In addition to its audits, the IAMB has asked for briefings from the CPA on key issues. These include the linkage between disbursements by the Program Review Board and actual

program delivery; the CPA's procurement process; how the CPA undertakes oil and gas sales; and the role of CPA's internal audit. The CPA has obliged and provided two such briefings; however, those briefings are not made public. As part of its self-declared mission to be fully transparent in its operations, the IAMB would be wise to publish the full text, or at minimum, a summary of these CPA briefings. The IAMB's meeting minutes do, however, indicate the Board's concerns, which are significant. The concerns center on:

Measuring oil extraction

Because the CPA does not currently meter how much oil is extracted, it is impossible to determine what amounts are smuggled prior to reaching refineries, shipping terminals, and pipelines.¹¹ The IAMB's meeting minutes do not include CPA briefings, so it is not known what steps the CPA is taking to eliminate this internal gap. The IAMB recommended urgent remedy of this control weakness.

Sole-source contracts

The IAMB expressed concern over the use of DFI funds to pay for a contract awarded to Halliburton with no competitive bidding. Halliburton is now the subject of criminal investigations by the Pentagon and Justice Department on a number of charges relating to its work in Iraq and some U.S. government payments have been withheld.¹² Last year's \$18.4 billion appropriation by the U.S. Congress specified that the funds could not be used to pay for any contract over \$5 million that had not been concluded using "full and open competition."¹³ Hence, outstanding payments to Halliburton were instead made through the DFI. The CPA's use of DFI funds to pay Halliburton is unacceptable because it asks Iraqis to pay for the U.S. government's poor procurement practices. In its briefing, the CPA indicated that no sole-source contracts had been awarded since January 2004, although contracts awarded in 2003 are still in effect. Sole-sourcing also continues at the sub-contracting level. When the contract is "cost-plus" (contractor is paid for all costs incurred, plus a bonus) the costs of the lack of competition at the sub-contractor level are passed on to Iraqis and to U.S. taxpayers. The IAMB has left itself the option of conducting a special audit of some sole-sourced contracts. Recent U.S. internal investigations and criticisms of contracting practices in Iraq may have prompted the IAMB at its March meeting to raise the possibility of launching a special audit investigation into DFI funds being awarded to Halliburton for fuel procured at inflated costs and without competitive bidding.

Financial Information

The IAMB has cautioned the Coalition Authority that the reporting provided by the DFI does not yet meet international accounting standards of financial reporting. The IAMB noted that the CPA possesses the information needed to provide reporting that meets such standards. The notes do not indicate, however, whether the CPA plans to improve its reporting on the DFI.

Bartering

To help overcome shortages of refined oil and electricity in Iraq, the CPA has bartered Iraqi residual fuel and crude oil with neighboring countries. This exchange, however, is not reported in the accounts of the DFI as required by UN Security Council resolution 1483. The CPA indicated that it would look for ways to ensure that equivalent proceeds from these exchanges are placed into the DFI. The accounts of the DFI, however, do not yet reflect a resolution of this issue.

Iraqi Ownership

The first draft of the IAMB's terms of reference provided no role for Iraqis to take part in the IAMB's work.¹⁴ Those terms of reference called for membership by the current four institutions (the UN, the Arab Development Bank, the World Bank, and the IMF), plus additional members that could be appointed by the CPA, or the IAMB with the CPA's consent. While the later, finalized terms of reference do allow for non-voting Iraqi observers, these terms are still insufficient. This is because the final terms provide no opportunity for including Iraqis on an equal footing with the current members.¹⁵ Iraqi partnership in the IAMB's work of examining the occupying Coalition's management of Iraq's resources over the past year is crucial to the legitimacy of the Board's conclusions. Moreover, as a soon to be sovereign nation that in its modern history has yet to see non-corrupt management of its vast resources, Iraq can set a significant new precedent by becoming an active partner in the IAMB's work.

In addition to the four members, the IAMB, "after consulting with the CPA Administrator," may add up to five observers from a list of "independent, qualified candidates, which should include Iraqi nationals nominated by the Governing Council of Iraq."¹⁶ At its first meeting, the IAMB decided to allow the CPA to submit its own nominations, and to seek an additional five names for consideration from the Iraqi Governing Council. Three observers have been approved. These include:

- ▶ *Dov Zakheim*, Under Secretary of Defense (Comptroller), who was appointed by the CPA;
- ▶ *Dr. Mehdi Hafedh*, Minister of Planning and Development Cooperation and Chairman of the Iraqi Strategic Review Board for the Reconstruction of Iraq, who was nominated by the Iraqi Governing Council;
- ▶ *Professor Mahdi Hadi Al-Kafaji*, nominated by the Iraqi Governing Council

The most recent meeting of the IAMB on March 17-18 was attended by the representative of one Iraqi observer, Dr. Mehdi Hafedh, who was represented by his deputy, Faik Ali Abdul-Rasool. Two members from the Iraq Board of Supreme Audit also attended the meeting, but have not been invited to join as observers.

It is a weakness of the IAMB that it includes no Iraqi voting members. At the March 17-18 meeting, the Iraqi observer requested that persons representing the Iraqi Governing Council be given the right to vote. This could be granted by proposing an amendment to the terms of reference, which require unanimous approval of all IAMB members and consultation with the CPA. The IAMB, however, was reluctant to make amendments and rejected the request.¹⁷

The failure to give Iraqis a vote may undermine the work of the IAMB. Its members recognize the importance of finding a way to transfer IAMB functions to an Iraqi entity after the handover of power to an interim government this summer. The IAMB has also begun consulting with the Iraqi Board of Supreme Audit about the handover. Yet Iraqi involvement in the IAMB continues to be kept to a minimum. The best way to ensure continuity of the IAMB's work is to give Iraqis more of a stake in the process. If Iraqi financial control professionals feel that they can only serve as observers of a process managed by others, they are unlikely to embrace the findings and methodologies produced by the IAMB. Full membership for Iraqis may also help improve their attendance at future meetings.

Conclusion and Recommendations

The creation of the IAMB is a welcome and long-needed step to bring oversight to the CPA's management of billions of dollars of Iraqi oil revenues and frozen assets. The questions posed by members have already identified areas of weakness in the CPA's financial control as well as means for correcting them. The website maintained by the IAMB is an informative resource. However, the IAMB's task is large and its time is short. The IAMB's work will only provide the basis for a new era of transparent revenue management in Iraq if Iraqis feel that they are part of the process. Below are several recommendations to make the Board more inclusive and effective:

- ▶ *Seek a UN mandate to continue work beyond June 30, 2004:* Given the delays in the IAMB's establishment and the large task it faces in auditing over a year's worth of revenue inputs and expenditures in a highly volatile environment, the IAMB will not be able to complete a full audit of the DFI by June 30, 2004. The Security Council's commitment to the Board's completion of its mission should be reaffirmed in a new UN resolution authorizing the IAMB to remain constituted and funded throughout 2004 and into 2005, if necessary, until a thorough audit of the DFI has been completed. Members of the Iraqi Governing Council should be involved in drafting this resolution, and the new sovereign Iraqi transitional government's endorsement should be sought and obtained after June 30th.

- ▶ *Include Iraqi voting members:* Since the IAMB is due to be dissolved this year, the best way to ensure the continuity of its efforts is to give Iraqis an ownership stake in it. The Iraq Board of Supreme Audit is likely to take over the work of the IAMB. Including someone from the Audit Board as a member of the IAMB would provide a good opportunity for a transfer of knowledge to that person.
- ▶ *Encourage the external auditor to begin work and publish results as soon as possible:* The IAMB approved an external auditor on March 24, nearly five months after the Board's creation. On April 5, the CPA announced that the audit contract for the Development Fund for Iraq had been signed by the CPA nominated and IAMB approved firm, KPMG Audit & Risk Advisory Services. According to the IAMB's press release, "the partners associated with the contract are Michel Picard and Abdul-Hakim Al-Adhamy.... In addition, the KPMG audit team will include other internationally specialist partners, as appropriate."¹⁸ With only a few months remaining for the IAMB to exercise its audit responsibility, it cannot afford to lose any more time. The IAMB should also provide information about the scope of the auditor's activities, explaining whether the auditor will examine all areas within the IAMB's mandate, or only a few selected issues. Staff of the Iraq Board of Supreme Audit should be invited to work side by side with the auditors, so as to learn best practices that they can employ in their own work.
- ▶ *Translate contents of the IAMB website into Arabic:* It is critical that Iraqis be able to access IAMB materials so they can see that the Board is carrying out its mandate of ensuring that Iraqi oil revenues are used for the benefit of the Iraqi people. Since few Iraqis speak English, these materials should also be available in Arabic for printed dissemination and on the IAMB's website. The Arab Fund for Economic and Social Development, an IAMB member, may be best positioned for providing these translations. At the time of this report's publication, the IAMB has begun to post links to Arabic translations on its website.¹⁹ This positive development should be built upon to include all key documents and resources on the IAMB site, such as meeting minutes and press releases.
- ▶ *Publish CPA briefing information:* The CPA has held several briefings with the IAMB about the DFI, oil and gas sales, and other matters related to the IAMB's mandate. The responses of IAMB members to the briefings provide key information about weaknesses in financial control mechanisms and the steps needed to correct them. However, the IAMB meetings do not include any information about the briefings themselves. Future minutes should summarize the content of those briefings to provide a more accurate picture of how Iraq's assets are being managed.

Appendix

Payment Summary from the Development Fund for Iraq as of April 8, 2004²⁰

Agriculture	\$7,144,437.50
CERP	\$160,077,500.00
Communications Infrastructure	\$20,000.00
Economic Programs	\$179,060,525.90
Fire Departments	\$2,510,250.00
Fuel Imports	\$1,025,275,407.28
Hajj	\$13,887,297.37
Health	\$1,565,005.70
Humanitarian	\$21,300,000.00
Import Electricity	\$28,252,323.80
Iraqi Civil Defense Corps	\$12,657,436.00
Ministry Affairs	\$885,733,893.24
Ministry Projects	\$3,373,516,240.04
Miscellaneous	\$81,723.64
Oil For Food	\$79,708,572.18
Police/Security	\$55,594,090.52
Rapid Regional Response Program	\$266,513,969.00
Reconstruction	\$33,002,966.41
Restore Electricity Infrastructure	\$68,731,382.46
Restore Oil Infrastructure	\$80,197,742.82
Rule of Law/Government	\$2,563,261.85
Wheat Purchase	\$128,362,523.50
World Food Program	\$910,000,000.00
	\$7,335,756,549.21

Notes

1. The IAMB's website is www.iamb.info
2. Joshua Chaffin, "Focus on Halliburton Obscures Deeper Problems," *Financial Times*, March 30, 2004.
3. See Paragraph 14 of UN Security Council Resolution 1483.
4. Draft of original IAMB terms of reference, June 11, 2003 and IRW interview with unnamed UN Security Council member representative, September, 2003.
5. The IAMB's terms of reference can be viewed on the Board's website at www.iamb.info.
6. *Reuters*, "Iraqi oil exports reach nearly \$6 billion," March 3, 2004. Also see the CPA website's DFI accounting spreadsheet, under sources and uses, "Oil Proceeds." www.cpa.gov.
7. See Appendix for breakdown of spending to date provided on the CPA website.
8. See the CPA website's DFI accounting spreadsheet, under payment summary, www.cpa.gov.
9. The Program Review Board has 11 members, only 1 of which is Iraqi (the Finance Minister).
10. Sue Fleming, "Halliburton Gets More Business in Iraq," *Reuters*, December 15, 2003.
11. Minutes of the IAMB meeting held at the Arab Fund Offices in Kuwait on March 17 and 18, 2004. On the problem of smuggling, see "Oil Ministry Cracks Down on Smugglers," *Iraq Press*, January 14, 2004; "Black Market Drains Iraq Oil; Pentagon Out to Stop Ships Plying Booming Trade," *The San Francisco Chronicle*, October 22, 2003.
12. "Criminal Probe into Halliburton", *BBC News*, February 24, 2004, <http://news.bbc.co.uk/2/hi/business/3515653.stm> and Sue Fleming, "U.S. Withholds 15 Pct Halliburton Bill", *Reuters*, March 17, 2004, http://biz.yahoo.com/rb/040317/iraq_halliburton_2.html
13. HR 3289, November 3, 2003.
14. IRW obtained a copy of the draft terms of Reference in July, 2003 from an anonymous UN source.
15. See www.iamb.info, "Terms of Reference" sub-section for the IAMB's official terms of reference.
16. *Terms of Reference*, International Advisory and Monitoring Board.
17. International Advisory and Monitoring Board. Minutes of the meeting held at the Arab Fund Offices in Kuwait on March 17 and 18, 2004.
18. International Advisory and Monitoring Board, Press Release, *Statement by the International Advisory and Monitoring Board on Iraq*, April 5, 2004, <http://www.iamb.info/pr/pro40504.htm>.
19. So far, the IAMB site has translated into Arabic the text of UN Security Council Resolution 1483, and the IAMB's terms of reference. See www.iamb.info, sub-section "Arabic Documentation."
20. See CPA website, DFI accounting under Budget and Finances section- www.iraqcoalition.org.

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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.

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