

**To,**  
**The International Advisory and Monitoring Board**

Sub: Report on factual findings related to export sales, exports of oil, and oil proceeds revenues account for the year ended 31.12.2006

The BSA followed up the observations raised in E&Y reports on factual findings relating to export sales and oil proceeds from sales for the period 01.01.2006 to 31.12.2006. Below are the follow up results:

**1. Recording of oil export sales**

- A. The report referred to non-existence of accounting systems and financial reporting for oil sales. SOMO agrees the need to develop a system to ensure proper maintenance of accounting transactions and reconciliation in line with international companies, but the company used the available computer programs and prepared by its IT's a developed data base to facilitate follow up, preparing financial statements and calculate prices. SOMO keens to improve its working systems and procedures, and will work towards installing a suitable system through the services of specialized parties in this field. SOMO confirmed its need to build an advanced system for the reconciliations.
- B. The report stated that SOMO did not carrying out reconciliations of export sales as per its books with oil sales proceeds as deposited in OPRA on a monthly basis and duly documented. SOMO commented that recording oil sales were based on sales commercial invoices and at dates of loading. Sales proceeds are recorded on basis of invoices received from CBI with monthly reconciliations to ensure that all invoices have been paid and on due dates. Our follow up showed that SOMO continued not reconciling between the records and the statements received from CBI.
- C. SOMO justified the use of exchange rate of one Iraqi dinnar for one US\$ in its books and accounting records by its desire to reflect factually the commercial transactions and for the purpose

of preparing reports and trial balances- US\$ is used for dealings, while recorded in Iraqi dinars are mostly related to oil producing companies. We do not share SOMO's point of view on this issue and we recommended that transactions in US\$ must be translated to Iraqi dinars at the prevailing exchange rate on dates of transactions. BSA requested clarification to this practice, which does not, affected the real oil exports sales revenues, but reflects incorrect values for these export sales in Iraqi currency; SOMO will amend the treatment in 2007 accounts.

- D. The reconciliation of oil sales revenues, as recorded in SOMO's books with oil proceeds deposited in FRBNY for the year ended 31.12.2006 revealed that SOMO's books agreed with E&Y report at US \$ 29801269433, and the difference of US \$ 369611 between this figure and what is shown as received by CBI for the account of MoF represents interest on delayed transfers which do not appear in SOMO's books. Further there was an amount of US \$ (5) million not shown in CBI's statement – 2006 but we confirm that it is shown in these statements at the beginning of 2007.
- E. The auditor's report stated that there was no monthly reconciliation by SOMO for the oil sales and oil proceeds as per CBI statements while SOMO replied that there is monthly reconciliation which disclosed the following matters;
- Seizure of US \$ 10886400 by an Italian Court for a claim against Ministry of Planning.
  - Commissions for the whole year of 2006 were only US \$ 245
  - Interest for delayed transfers totaled US \$ 372711.21 in favour of MoF.

We agree with the auditor observation that was no monthly basis reconciliations.

- F. With regard to the difference of 1590999 barrels of oil between SOMO's records and south oil company's reports, the auditor's report stated that he requested but not received any justification for it. SOMO replied that it recording was based on loaded quantities at dates shown by the bills of lading for the period 01.01.2006 to 31.12.2006 while the south oil company records

are on actual loading from zero hour of the first day to 24 hour of the last day of the year. Our follow up revealed that the differences are according to the reason given by SOMO but could not breakdown the differences by months. The differences represents 0.0024 of the annual exports for 2006 and the source of the difference is as given above not to delay of recording for over 24 hour at end of year.

G. SOMO agreed with the auditor's comments about the demurrage during 2006 which totaled US \$ 16017454.

## **2. Oil products**

A. SOMO confirmed the auditor's observation that it received payment in advance for export oil products.

B. The advance receipts for oil products sales as shown in the auditor's report and by SOMO's records is US \$ 638192881 during the year ended 31.12.2006. But SOMO replied that the total was US \$ 640952028. SOMO is investigating the difference of US \$ 2759147.

C. Sales of oil products apart from barter sales for the year ended 31.12.2006 and as per SOMO's books were

	US \$
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Export sales of oil products	647651302
Deposited in SOMO's bank account	638182881
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Difference	9458421

Our follow up confirmed this difference and SOMO is investigating it. SOMO on the other hand stated that there is no difference as per its books and there is a mix up in the figures reported by E&Y (cash sales + barter sales) and the difference is in total sales of oil products and as explained below:

### **I. Cash sales**

The figure reported by E&Y of US \$ 647651302 for cash sales contained sales made to Cartet Co. totaling US \$ 3475977 shown in

SOMO's books as barter sales due to the special nature of the contract with the stated company.

## **II. Barter sales**

There are old accrued amounts from Aram Company and Delta petroserf Co. totaling US \$ 2927314 not added to barter sales by E&Y and the difference is due to SOMO not providing information to E&Y prior to completion of invoices issuing, reconciliations and preparation of final balances.

- D. SOMO confirmed the auditor's statement that gross advance of oil product sales proceeds totaling US \$ 638192881 were deposited in SOMO's bank accounts opened at TBI, Rafidain bank in Baghdad and Amman. We also confirm that these proceeds are then transferred to the oil products distribution company as directed by Ministry of Oil.
- E. SOMO responded to the auditors' observation about bank reconciliations that these reconciliations were made half yearly as the information from various banks were received very late and specially from TBI.
- F. SOMO endorsed auditor's observation that there were large outstanding amounts with TBI and SOMO is addressing these amounts. According to our follow up, the total of the outstanding is around US \$ 620 million recorded in the bank statements but not shown in SOMO's record as no notifications in respect thereof were received from the bank. The account with outstanding amounts has been closed for gradual clearance and a new account opened. A committee has been formed in SOMO as per its letter no. 7617/1/2 dated 22.04.2007 to clear and reconcile the outstanding amount.
- G. The auditor reported that there was an amount of US \$ 34397236 due to SOMO from Ministry of Electricity was not settled. SOMO has informed us that the MoE had paid US \$ 15203835 of the barter sales and SOMO will follow up settlement of the remaining amount of US \$ 19193410 and the

MoE had asked the MoF to pay the amount by letter no. 6843 dated 03.04.2007.

- H. SOMO did not agree with the auditor's comments about the agreement signed between SOMO and the Turkish Co., the monthly allocation of 30000 tons was not exceeded. The quantities shown by the auditor included carry over from previous months (due to security conditions). Our follow up confirmed that the monthly allocation of 30000 tons was not exceeded with the exception of April. Furthermore, the yearly allocation was not exceeded.
- I. SOMO agreed that there was no export to the Jordanian Refinery as per agreement between the two parties due to the security situation in Iraq.

### 3. **Barter transactions**

- A. SOMO agreed with the auditor's observation regarding settlement with the Syrian Government final settlement for 2006 is expected to be arrived at during a forthcoming delegation visit to Syria.
- B. SOMO also agreed that 75% of the amount due from the Syrian Government and totaling US \$ 92324823 had not been paid as per agreement. SOMO mounting efforts to obtain this amount.

### 4. **Internal control**

The auditor commented that internal controls were ineffective and metering was incomplete and sabotage was continuing. Thus it was impossible to quantify all exports of oil and oil products and their proceeds and their deposit in OPRA. In addition there was no reconciliation between oil produced and oil distributed and exported. Our audit team at the MoO has reported that Parsons Co. had rehabilitated 10 meters and installed two new ones but has not been put in function yet. The pipeline Co. had not installed any of the 63 meters received since 2001 from the Italian Furanti Co.

## **5. Investigation of export sales of oil and oil products**

- A. The auditor commented that there were no documented procedures for oil sales acquisition approved by the Iraqi Government. SOMO replied that the adopted procedures were to contract directly with oil companies that owned large refineries and if oil is accumulated at Kirkuk tank farms acquisition (to the highest bidder) is resorted to. SOMO agreed with the auditor's comment stated above and our follow up confirmed that acquisition procedures were followed for some sales in Kirkuk with the approval of the Minister of Oil. There was a committee to open tenders and another to analyze bids received and then a purchaser company is selected.
- B. The auditor stated that no acquisition procedure was applied in sales during 2006 with the exception of Kirkuk oil sales. SOMO replied that it was unusual to sell crude oil through acquisition as such sales are long term and require continuous commitment due to continuity of production and to avoid stoppages. As for Kirkuk oil, the security conditions prevent it from reaching loading terminal on a continuous basis. Hence acquisition was possible. We support SOMO's explanation and the special circumstances of each Basrah and Kirkuk sales.
- C. SOMO said there were two committees, one for opening tenders and the other for analyzing the offers and the choice is based on the best price. Further the requests for offers are published through normal oil media. Our follow up confirmed the above and auditor's comments in this regard are not accurate.
- D. SOMO did not agree with the auditor's remarks that the clients with whom SOMO dealt were not investigated for their financial standings and abilities SOMO indicated that it dealt with well known international companies and SOMO has been in business with them for long time. Our examination of sample cases confirmed what SOMO had stated.
- E. SOMO did not agree with the auditor's remark about not having a manual of procedures for preparing, reviewing and approving sales invoices. SOMO explained that it used two computer programs for this purpose - Excel and Access. Data is prepared from nomination of tankers until receipt of bills of lading from Basrah port.

Although there is no manual of procedures but there is a computer program.

- F. SOMO confirmed there were authorities and responsibilities schedules and our follow up confirmed this fact and many executive orders had been issued specifying authorities to some personnel. Therefore, SOMO did not agree with the auditor's comments on this matter.
- G. SOMO clarified that a committee headed by an advisor (Abdul Sahib Al – Kutub) is authorized by the Minister to approve sales contracts and contracts amendment. Our follow up revealed that a copy of such authorization, which authorized the above-mentioned advisor to approve and amended contracts, was not submitted.
- H. SOMO explained that the financial manager has the authority to issue invoices, as these are not payment orders. We agree that the financial manager has no clear authority to sign invoices and we addressed to SOMO to give required authority to the financial manager.
- I. SOMO explained that the delay in signing some oil contracts is to speed them up and to ensure the flow of exports. Thus, the purchaser sends a letter of confirmation for the contract and signs the contract later. Our follow up confirmed the delay in signing contracts and we do not agree with SOMO's justification and have informed SOMO with our standing.
- J. E&Y report stated that SOMO did not ask or received delivery certificate from the purchaser for each shipment to ensure compliance with contract's terms. SOMO replied that it requested for such certificate, and will rely on "Loyds" Co. to verify discharging. We concur with E&Y observation.
- K. SOMO did not agree with the auditor about the need of confirmation from a third party about receipt of loaded quantities. SOMO added that such practice is not familiar and "Loyds" Co. follows the movement of oil tankers and auditor suggestion will disturb exporting process. We do not share SOMO's justification as Iraqi oil sales are on FOB basis.
- L. SOMO did not agree with the auditor about the absence of code numbers stating that it prepares loading card for each accepted purchaser and that card has code number, and there are shipment

numbers given by the port, all these codes are indicated on bills of lading and invoices. We confirm what SOMO stated, but we prefer to combine the various codes and numbers into one numerical system placed on all documents related to sales.

M. SOMO did not agree with the auditor's observation about demurrage and stated that their amounts were checked against contract, and calculated by marketing department, and then, checked by legal department. There after it has to be approved by head of sales committee and the director general before it is passed to financial department to retain the amount from the succeeding invoice.

We do not agree with SOMO's replay as we detected many cases of large differences in demurrage amounts calculated in excess in many cases and were not deducted from the commercial invoices or were not detected by internal audit or other departments. BSA has already made same comments in its audit reports.

N. SOMO confirmed that the difference of 194 barrels was due to a typing error. The difference arose between quantity exported in export statement and the quantity shown on bill of lading. There were no consequences because of this error as the quantity as per bill of lading agreed with the quantity showed on Basrah Port documents.

O. SOMO admitted that two oil sales invoices with the same number were issued for two different purchasers. SOMO has since amended its program to avoid recurrence. Our follow up confirmed that the amounts of the two invoices were paid on 28.07 and 28.08.2007.

P. SOMO did not agree with auditor about existence of differences between prices shown on invoices of oil products and the prices calculated by auditor on basis of "PLATTS" for seven invoices quoted by the auditor are different from the real commercial invoices with the same number. This indicates that the auditor comment is not accurate.

Q. SOMO did not agree with the auditor that calculation of the official monthly price for each direction of oil was not properly documented. SOMO explained that the equation of official monthly price is calculated through a series of meetings and



discussions between specialists from crude oil department, after which a letter will be prepared for the Minister for approval. As for freight costs, the purchaser is compensated if the basic rental exceeds 40 points and likewise the purchaser compensated SOMO if the basic rental falls below 40 points.

Our follow up reveal that SOMO's reply was not precise. There were no documented procedures in calculating the official monthly price for each direction. Minutes of meetings of the marketing committee were not attached when Minister's approval was sought, but such minutes were sent with subsequent letters.

- R. The auditor was not provided with the approval of calculation of API Escalation for Basrah and Kirkuk oil. SOMO explained that oil marketing faced complains from purchasers in Oct. 2004 because of hose differences appearing in the international market between heavy and light crude prices. SOMO was compelled to reconsider the quality compensation by 40 cents for each point, instead of 10 cents as applied previously especially as Basrah is high in sulfur content and low in API, the Minister, who attended the meeting, approved the proposal to deal with the withdrawal of some purchaser due to the big jump in prices. At the meeting it was decided to compensate the purchaser through changing the pricing formula retroactively and change in quality compensation. Minister's approval was obtained.

Our follow up has shown that SOMO was right in respect with compensation for API differences as the Minister approval dated 16.12.2004 did not clearly refer to adoption of price change and for all future cases.

- S. The auditor reported that SOMO did not have official documentation for its policy in determining the prices of delayed shipments from the original month of shipment. SOMO explained that price difference appeared between current month and succeeding month and to prevent manipulation of purchasers, in bringing forward or delaying nominated tankers, to take advantage of price difference. SOMO's management decided since 2004 to adopt the monthly price formula for the nomination for each month and apply it on all nominated tankers and accepted even if they are not loaded in the same month and delayed to the next

month. We support SOMO's explanation and crude oil sales contracts have been amended accordingly and since 2005.

- T. The auditor commented that meetings of the pricing committee were not documented. SOMO replied that during the first four months of 2006 combined minutes of meetings were contained in the letter addressed to the Minister to obtain his approval. Thereafter, separate minutes were prepared and attached to the letter addressed to the Minister.