

Keeping Secrets:

America and Iraq's Public Finances

A report prepared by the Iraq Revenue Watch Project, Open Society Institute
October 2003

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Overview

As the Bush Administration seeks billions more for reconstruction in Iraq the management of Iraqi oil revenue deserves more attention. As the primary repository for Iraqi oil and gas revenue, the Development Fund for Iraq (DFI) plays a crucial role in fostering public confidence about how the occupying powers manage the country. Yet hopes that the Fund would be an example of transparency, good governance, and civic participation have been disappointed. Almost five months after establishment of the DFI and following some \$1 billion in expenditures there is minimal information about these financial flows and no mechanisms have been established allowing the international community to monitor the Fund. With international donors gathering for an Iraq reconstruction meeting in Madrid on October 24 the operations of the DFI must become a priority.

On May 22 the UN Security Council Resolution 1483 acknowledged the DFI's establishment to meet the humanitarian needs of the Iraqi people and finance the reconstruction of Iraq's infrastructure. The DFI is the sole repository for Iraq's oil revenues, and its remaining revenue streams come from the transfer of frozen assets from abroad, and funds remaining from the UN oil-for-food program.

The terms establishing the DFI require it to be "managed in a transparent manner for and on behalf of the Iraqi people."¹ Provisions in Resolution 1483 hold the DFI to high standards of transparency and accountability and these clauses are mirrored in the DFI's founding regulations under the U.S.-U.K. led Coalition Provisional Authority (CPA).²

The CPA's initial emphasis on high standards of transparency and accountability for the DFI was a necessary and positive step toward institutionalizing democratic governance and civic participation in Iraq. Unfortunately, the CPA has done little to implement these standards.

¹ See UN Security Council Resolution 1483, http://news.bbc.co.uk/1/hi/world/middle_east/3012847.stm.

² See CPA website, DFI and PRB founding Regulations 2 and 3, <http://www.cpa-iraq.org/regulations/REG2.pdf> and <http://www.cpa-iraq.org/regulations/REG3.pdf>

The International Advisory and Monitoring Board (IAMB), an international body intended to oversee DFI disbursements, has yet to be established. Administrator Bremer has so far opposed an IAMB mandate that would grant the Board expansive, independent auditing powers.³ Instead, DFI expenditures have been managed by a Program Review Board (PRB) designed by and comprised of CPA appointees, only one of whom is Iraqi.

It is critical to Iraq's economic and political development that the DFI emerge as an efficient, transparent, and accountable funding mechanism. To ensure the effectiveness and credibility of Iraq's public funds, this report calls upon the relevant authorities to do the following:

- Establish the IAMB, as mandated by the UN, and afford it *full* auditing authority;
- Improve the transparency of both the DFI and the Program Review Board (PRB);
and
- Empower Iraqis to participate in the fiscal oversight of their country.

This report also explains the structures for collecting and overseeing Iraq's oil revenues, and provides recommendations to improve the transparency, inclusiveness, and accountability of these institutions.

Failure to improve the management of Iraq's public finances and reconstruction effort risks prolonging the cost to all involved in terms of dollars and lives. Without change, U.S. authorities in Iraq likely will find themselves increasingly isolated as international donors lose confidence in the CPA's efforts to stabilize and rebuild Iraq. The world community must take advantage of this unique opportunity to institutionalize the highest standards of resource management in Iraq, and prevent one more country from succumbing to the poverty and corruption that plague so many resource-rich countries.

Development Fund Structure and Boards

Development Fund for Iraq

The DFI is maintained on the books of the Central Bank of Iraq, but held by the U.S.

³ Interviews with numerous UN officials, also see Alan Beattie, Charles Clover, Guy Dinmore and Mark Turner, "Annan Deals a Blow to US Draft Resolution on Iraq Reconstruction", *Financial Times*, October 3, 2003.

Federal Reserve Bank of New York.⁴ The Fund is the repository for Iraqi oil revenues and formerly frozen Iraqi assets from abroad.⁵ The DFI receives 95 percent of the proceeds from the sale of Iraqi oil and natural gas, with 5 percent going to the UN's Gulf War Compensation Fund.⁶ The DFI is supplemented by the remaining funds from the UN Oil-for-Food Programs account.⁷ The Fund also receives transferred financial assets from overseas that were removed from Iraq by Saddam and his officials during his regime. This month an international donors' conference in Madrid, Spain, will decide whether non-coalition foreign aid will go into the DFI, or a separate multi-donor Iraq trust fund.

The two main oversight structures for the DFI are the Program Review Board and the International Advisory and Monitoring Board. Currently, the PRB manages the Fund under the supervision of the American-British-led CPA headed by Administrator Bremer. The IAMB is still being established, and at present, its responsibilities are limited to auditing the collection and use of DFI funds.

As of August 12, the DFI account held a current balance of (US) \$1.4 billion.⁸ To date, DFI funds have been used to pay Iraqi public sector salaries, to compensate families for the loss of members by actions of Coalition Forces, and the day-to-day functioning of the Iraq Governing Council and Ministries.⁹

The Program Review Board

The PRB recommends specific DFI expenditures for the CPA administrator to approve. The Board works within the CPA's Office of Management and Budget and reports directly to Administrator Paul Bremer through his appointed acting PRB chair, Sherri Kraham.¹⁰ After the PRB approves funds, they are disbursed to the Ministry of Finance,

⁴ See <http://www.cpa-iraq.org/regulations/REG2.pdf>.

⁵ See UN Resolution 1483, as well as founding DFI Regulation, <http://ods-dds-ny.un.org/doc/UNDOC/GEN/N03/368/53/PDF/N0336853.pdf?OpenElement> and <http://www.cpa-iraq.org/regulations/REG2.pdf>.

⁶ See UN Resolution 1483, as well as founding DFI Regulation, <http://ods-dds-ny.un.org/doc/UNDOC/GEN/N03/368/53/PDF/N0336853.pdf?OpenElement> and <http://www.cpa-iraq.org/regulations/REG2.pdf>.

⁷ See UN Resolution 1483, as well as founding DFI Regulation, <http://ods-dds-ny.un.org/doc/UNDOC/GEN/N03/368/53/PDF/N0336853.pdf?OpenElement> and <http://www.cpa-iraq.org/regulations/REG2.pdf>.

⁸ www.cpa-iraq.org, see August 12 PRB minutes, under Budget section.

⁹ Coalition Provisional Authority Website, Ministry of Finance section, http://www.cpa-iraq.org/ministries/cpa_Aug_salaries_Eng.pdf, also, see Iraq's Public Budget for 2003 at <http://www.cpa-iraq.org/ministries/Final2003Budget.xls>.

¹⁰ For a chart of the CPA's organization structure, see <http://www.cpa-iraq.org/CPAorgchart.pdf>.

which is then responsible for distributing money to all other ministries.¹¹ Other key bodies related to economic policymaking are the Planning Ministry and the Oil Ministry, which is run by a returning exile.¹²

The PRB has 11 voting members representing the CPA, and 10 non-voting members (see Appendix 1 for full list). According to the PRB's founding regulations, the PRB must operate transparently and is required to: 1) publish and broadly disseminate funding plans in Arabic, and 2) publish the minutes of all formal sessions of the PRB.

The International Advisory and Monitoring Board

UN Resolution 1483 set up the IAMB to address relations between the United Nations and the U.S. and British-led occupying forces. It is the primary vehicle for guaranteeing the transparency of the DFI and for ensuring that DFI funds are used properly.

Although mandated nearly five months ago by the UN, the IAMB has yet to be established and begin operating. Much of the delay is due to negotiations between the IAMB's potential members and the CPA over the extent of the body's mandate.¹³ Disagreements between the coalition and international institutions have centered specifically on proposals for a system of "special audits," which would allow the monitoring board independent powers to look at any expenditure in depth.¹⁴ IAMB members have agreed on revised terms that include this special auditing power, and these were sent to Administrator Bremer by the Secretary General in late September 2003. As of early October, Administrator Bremer has still not approved the terms of reference for the board. According to UN Security Council officials interviewed, he is seeking veto power over IAMB special audits—a demand that international institutions view as an unacceptable check on their independence.¹⁵

The IAMB is comprised of four members representing the UN, the International Monetary Fund, the World Bank, and the Arab Fund for Social and Economic Development.

¹¹ See CPA website, Ministry of Finance section, <http://www.cpa-iraq.org/ministries/finance.html>, and CPA Memorandum 4 on PRB Regulation 3, http://www.cpa-iraq.org/regulations/CPAMEM04_AND_APPENDICES.pdf.

¹² Ferry Biederman, *Mostly Outsiders Appointed Ministers*, Inter Press Service News Agency, September 4, 2003.

¹³ Gathered from discussions with various UN officials and SC diplomats.

¹⁴ Beattie, Charles Clover, Guy Dinmore and Mark Turner, "Annan Deals a Blow to US Draft Resolution on Iraq Reconstruction", *Financial Times*, October 3, 2003.

¹⁵ Gathered from discussions with various UN officials and SC diplomats.

Council for International Coordination

The Council for International Coordination (CIC) advises the PRB on matters relating to international efforts to assist Iraq's recovery and development of its economy. CIC activities include raising funds from the international community, proposing specific projects for funding consideration, and, *as requested* by the PRB, making recommendations with regard to disbursements from the DFI.

The CIC is made up of representatives from CPA countries participating in the Coalition and other individuals hand-picked by Ambassador Bremer.¹⁶ The CIC is charged with reviewing and reconciling needs information and assessments from various ministry budgets, the UN, the World Bank, and NGOs.¹⁷

Areas of Concern

The funds and various boards created to rebuild Iraq have significant shortcomings. Given public doubts within Iraq and internationally about the motives of the U.S. intervention, and the increasing costs of the occupation and reconstruction, it is high time that urgent solutions that can accommodate the interests of the Iraqi people, the mounting concerns of the American people, and the legitimate questions raised by the international community be put in place. If the areas of concern described below are not addressed quickly, the reluctance of many potential contributors to Iraq's reconstruction will continue to grow, and Iraqi faith in the CPA's management of its finances will falter.

Development Fund for Iraq

Contracts and expenditures

Bidding processes for reconstruction contracts have taken place behind closed doors, and then publicly reported by the CPA only after award decisions have been made.

Anwar Diab, an Iraqi businessman recently returned from Baghdad, believes there is a fundamental lack of transparency in CPA contracting practices at present. This,

¹⁶ The following are represented on the CIC: Poland, Australia, Italy, Denmark, the Czech Republic, the United States, South Korea, Japan, Spain, the United Kingdom, Singapore, Jordan and Romania as well as an observer from the United Nations Office of the Humanitarian Coordinator for Iraq.

¹⁷ L. Paul Bremer, Remarks, Opening of the Council for International Coordination, 17 August 2003.

coupled with a lack of Iraqi Ministry participation, means that it is difficult, if not impossible for Iraqi vendors to compete with their American counterparts. Mr. Diab says that "often American products are asked for specifically by name, and it appears that bids are written to legitimize offers that have already been received." Moreover, "contractors are asked to submit bids... then they hear that the first part of a contract has been cancelled...and the second part is being split among four favorites- how were these favorites decided, on what merits? No one knows."¹⁸

The French UN Mission's First Secretary Damien Loras notes that it is nearly impossible for the international community to determine how DFI funds have been disbursed. "Spending should not have happened without the IAMB in place," says Loras. "We don't know if spending is being done consistent with Resolution 1483. Moreover, what does it signal that the DFI account of the Iraqi central bank is being kept in a Federal Reserve Bank in New York?"

Access to information

The Department of Defense, the Office of Management and Budget, and other agencies within the Bush Administration have refused to disclose basic information about large purchase contracts and DFI expenditures in Iraq.¹⁹

A Government Reform Committee staffer, who spoke on condition of anonymity, said getting information on contracting in Iraq has been "maddening, like running up against a brick wall."²⁰ The staffer noted that agencies under the Administration's control had thwarted efforts by the United States Army Corps of Engineers to provide information.

According to a Security Council diplomat, who asked to remain anonymous, "The international community knows absolutely nothing about the Fund's management; we know that \$1 billion went into it from the UN Oil-for-Food program in May. Since then, that money has disappeared, and there are rumors that the current balance is zero."

¹⁸ Interview with Anwar Diab, October 8, 2003.

¹⁹ Gathered from conversations with Government Reform Committee staffer and SC diplomats, also see Rep. Waxman's article *Evidence Of Waste Of US Taxpayers' Dollars In Iraq Contracts*. <http://www.mees.com/postedarticles/oped/a46n40d02.htm>.

²⁰ Because of the sensitivities surrounding questions of financing Iraqi reconstruction, many sources agreed to speak only on condition of anonymity.

Program Review Board

Oversight and inclusion

The PRB allows only one voting Iraqi on its 11-member board. Minister of Finance Kamal al-Kilani, the current Iraqi board member, is considered by many Iraqis as a pro-U.S. outsider.²¹ According to the PRB meeting minutes made public so far, al-Kilani was not in attendance. Beyond al-Kilani, Iraqi participation in the PRB is limited to public outreach meetings with Iraqi specialists.²²

One former Iraqi advisor to the CPA who asked to remain anonymous told Iraq Revenue Watch that the CPA Economic Policy Office operates behind closed doors without Iraqi involvement to determine what is presented to the PRB for consideration. The Iraqi Planning and Oil Ministries are supposed to be involved in economic policy making, but do not have representation on the PRB. It is unclear how the CPA intends for them to participate in decision making, particularly regarding contract decisions and oil production and sales.

In terms of international consultation, a UN legal expert working closely on Iraq, who also request anonymity, told IRW that, "The UN is given 24 hours to comment on a 360 page document, and then the next day the document is published as law with a preambular paragraph claiming to have consulted with the UN."

Access to information

The PRB has met twice a week since July 2003.²³ Yet by mid-September 2003, the CPA had only produced minutes for one August meeting. Finally, on September 24 the CPA published eight sets of PRB minutes, documenting the approval of approximately \$1 billion in expenditures between August 12 and September 2, 2003. There is no current balance for the DFI in the last minutes published by the CPA.

Overall, the PRB minutes do not encompass all DFI funded projects (information, which, to date, is not available anywhere); they do not disclose the DFI's current balance; and they do not always make clear whether DFI funds or U.S. appropriated funds are at stake in expenditure decisions. On September 26, the CPA responded to IRW inquiries and said that although the PRB is committed to transparent operations,

²¹ Ferry Biederman, "Mostly Outsiders Appointed Ministers", *Inter Press Service News Agency*, September 4, 2003.

²² Anonymous Iraqi former CPA advisor.

²³ Interview with senior IMF official, September 2003.

it lacks the “resources, staff and time” to maintain the level of transparency it aspires to.

There is no regular reporting about the PRB’s activities on the CPA website. Likewise, there is no information about the CPA’s Office of Management and Budget within which the PRB functions, although the site does provide links to every other CPA office. The PRB has also not published its minutes in Arabic as of this report, which it is required to do by its founding regulation.

International Advisory and Monitoring Board

Oversight and inclusion

Reflecting the language of UN Resolution 1483, UN member states expected the IAMB to function as the Security Council’s “eyes and ears” on the DFI. Yet Security Council members and UNDP officials say that Administrator Bremer and the Bush Administration strongly opposed ceding substantive authority to the IAMB.

France, Germany, and Russia found the first U.S. proposed draft of the IAMB’s terms of reference unacceptable because they limited the IAMB’s role to simply confirming the appointment of U.S. picked accountants and checking whether accounting reports were consistent with international standards. Essentially, under these terms the IAMB’s only function would have been to audit the auditors.

Revised terms agreed to by IAMB members give the board broad powers to audit oil exports as well as DFI receipts and expenditures. The board, however, still has no authority over DFI spending, and hence is limited to a backward looking audit function after spending decisions have been made. As previously noted, these terms are pending approval by Administrator Bremer, who opposes the “special audit” authority requested by IAMB members.²⁴

Despite the revisions, the draft terms of reference offer only a possible role for Iraqi participation, and have no actual requirements for the inclusion of Iraqi board members. The terms also lack specific reporting and procedural requirements.

²⁴ Interview with UN Security Council permanent member, September 2003.

Many countries with frozen Iraqi assets are reluctant to release them until the IAMB is formed.²⁵

International Skepticism

The United States' administration of Iraqi development funds and its efforts to limit the power of the IAMB have created a growing sense of frustration among members of the international community.

One Security Council diplomat interviewed for this report predicts that absolutely no money will flow into the DFI from the international community, unless there is a sudden change in CPA attitudes and practices regarding transparent management. Moreover, he said, "We will not donate money to the DFI unless we can be sure that it will not go straight to the Halliburtons, Bechtels, etc., and that there is Iraqi ownership and participation in the budgetary and contracting processes."

The international community's skepticism toward U.S. reconstruction plans has prompted calls for the upcoming international donors' conference in Madrid to channel contributions into a separate international Iraqi reconstruction fund. France and Germany are among the countries pushing for such a fund, which would be managed by the UN, the World Bank, and possibly the IMF.

Gunter Pleuger, Germany's ambassador to the United Nations, says "We believe that the necessary international support will only be forthcoming if full transparency and international participation in the decision making process are assured. The creation of a separate international fund could dispel some concerns, expressed by some members of the United Nations, with regards to the (US-controlled) Development Fund for Iraq."²⁶

The international community's frustration with the lack of transparency and cooperation is justifiable. However, the possible splintering of Iraq's resources is a disappointing development, which could have been avoided by applying international best practices in transparent management to the DFI from the beginning.

Two separate funds could conceivably create significant complications for any eventual interim Iraqi administration attempting to make already difficult financial

²⁵ "No Board yet for Iraq Development Fund -US Treasury", Reuters via Forbes online, 8.25.03, <http://www.forbes.com/markets/newswire/2003/08/25/rtr1065940.html>.

²⁶ Mark Turner, "Separate fund for donations is urged", *Financial Times*, July 23, 2003.

decisions. Potentially substantial oil revenues and American aid to Iraq would flow through the DFI, while significant European and UN aid would be disbursed under a different spending umbrella with priorities and accountability mechanisms potentially at odds with that of the CPA-controlled DFI.

It is critical that Iraqi funds are held to the same standards of inclusion, transparency, and efficiency as the donations of their international counterparts. By fully and promptly living up to the CPA's obligations regarding transparency and accountability for the DFI, U.S. authorities in Iraq can restore public confidence and avoid forcing Iraqis to mitigate political differences over the management of their finances between donors and funds.

Recommendations

To address the concerns highlighted above, this report provides the following recommendations on improving fiscal transparency in Iraq:

Development Fund for Iraq and the Program Review Board

- *Make DFI information accessible and easy to find.*
Currently, PRB information regarding contracts, tenders, trade developments, currency decisions, and oil activities in Iraq is published sporadically and across a broad range of US Government and Coalition related websites. Information about Iraq's public finances should be published in one central location, updated as frequently as possible and available in both English and Arabic. Reporting should include a record of all flows to and from the DFI. Contracts for selling Iraq's oil and gas as well as all payments that Iraq receives for these exports should be reported, as called for by the G8 and the Extractive Industries Transparency Initiative.
- *Publish all PRB activities.*
Current levels of PRB/DFI disclosure are inadequate, and are in violation of the regulations establishing these bodies. All minutes of PRB meetings *to date* should be published, available in Arabic and English, and should appear in one central forum (such as the CPA website) in a timely and consistent manner.
- *Expand voting and transfer more financial control to Iraqis.*
Substantive and incrementally greater Iraqi control of DFI funds through the PRB is critical to restoring international and Iraqi public trust in the CPA's management of Iraq's financial assets and resources. A stage-based timeline

for this hand-over should be established and disseminated as soon as practicable. Iraqi representatives from all ministries should be present at all PRB meetings, and included *as voting members* in all decisions that affect their ministry's budget and operations.

- *Transfer the Chairmanship of the PRB to an Iraqi*
The Chair of the PRB should be an Iraqi, perhaps from the Governing Council, instead of the current American chair; this is the person who sets the agenda for meetings and interfaces with Administrator Bremer on the Board's decisions. It is critical that given these responsibilities, the Chair is an authentic platform for Iraqi priorities, and represents an Iraqi perspective to the Administrator.

International Advisory and Monitoring Board

- *Establish the IAMB and give it a significant role in Iraq's reconstruction.*
The IAMB's terms of reference should be completed, these terms should include a tender auditing role, and the Board should begin operating as soon as possible. It must have substantive involvement and influence with the DFI in order to restore donor confidence. A credible and effective Board is critical to preventing the need for multiple reconstruction aid funds and the administrative and political complications they can create.
- *Encourage the IAMB to pro-actively monitor transparency compliance.*
The IAMB should work with the PRB to increase compliance with the Fund's fundamental rules on governance and transparency.
- *Clarify whose interests the IAMB members represent.*
Although IAMB members are representatives of international institutions, the terms of reference should clarify that board members act as fiduciaries on behalf of the people of Iraq and that its monitoring and advisory activities must always prioritize the interests of the Iraqi people. These fiduciary responsibilities include ensuring efficient administration, securing the best available services and goods for Iraq, and supporting the development of Iraqi businesses and the nation's public institutions.
- *Plan for a smooth transition.*
The IAMB is a temporary body that will be dissolved once an internationally recognized representative government is formed in Iraq. To ensure a smooth transition, it is essential to include Iraqi representatives who will eventually take over the IAMB's role. Board membership or observer status must be

extended to Iraq's supreme audit board and to representatives from the Iraqi Finance Ministry.

- *Clarify selection of new IAMB members.*
The terms of reference for the IAMB allow for five additional IAMB members. While the document stipulates that the list of potential candidates should include Iraqis nominated by the Governing Council; the terms do not require that Iraqis be chosen. To ensure greater Iraqi inclusion, mandatory levels of Iraqi participation in the IAMB should be stipulated and required in the IAMB terms of reference.
- *Give the IAMB a tender audit role.*
To help IAMB monitoring ensure that DFI assets are used for the benefit of the Iraqi people, the board's mandate should include audit of contracting procedures, with World Bank or U.S. government contracting standards as appropriate guideposts. This should include the authority to conduct audits to determine whether contracts are awarded on a competitive basis, and mandatory consultation between the CPA and IAMB when the CPA wants to award large, no-bid contracts. The IAMB should also be mandated to conduct independent cost estimates for large purchase and non-bid contracts before they are awarded. If audits completed by the IAMB reveal discrepancies in tendering procedures, in expenditure allocations, or other areas within the IAMB's mandate, the IAMB should be authorized to subpoena documents and witnesses to clarify the discrepancy. All such proceedings should be documented and reported.
- *Specify reporting requirements.*
The inclusion of a reporting requirement is an important step in ensuring the transparency of the IAMB. Disclosure should be strengthened with a clause specifying how soon reports must be made available after the completion of audits. Disclosure requirements should also mandate that that IAMB reports are "easily accessible" to the public. Such requirements will prevent the problems of availability and access that mark the PRB's disclosure of meeting minutes.

APPENDIX 1: Members of the Program Review Board

Voting Members*

1. PRB Chair
2. Director, Economic Policy
3. Director, Civil Affairs Policy
4. Director, Agency for International Development, Iraq mission- Lewis Lucke
5. Director, Operations
6. Director, Security Affairs
7. Commander of Coalition Forces
8. Iraqi Ministry of Finance
9. United Kingdom
10. Australia
11. Chairman, Council for International Coordination

Non-Voting Members

1. CPA Comptroller
2. CPA General Counsel
3. Program Coordinator of the Board
4. Chairman, Council for International Coordination
5. U.S. Office of Management and Budget
6. U.S. Office of the Secretary of Defense
7. International Monetary Fund
8. World Bank
9. U .N. Special Representative of the Secretary General for Iraq
10. International Advisory and Monitoring Board

*Members of the PRB are not named here specifically, because their representation has varied from meeting to meeting. Meeting attendance records can be found on the CPA website within the PRB minutes at http://www.cpa-iraq.org/budget/program_review_board.html.