

December 11, 2012

TO: Nael Shabaro

From: Michael Schaeffer

Cc: Miraq Aljubouri

Re: ComSec Public Fiscal Reform Budget Meeting – December 10, 2012

Attendees

1. On 10/12/2012, a meeting was held at the Ministry of Agriculture (MoA) with Dr. Obaid Mahal Fraij (ComSec Finance Secretary); Dr. Ghazi Al-Abodi (Deputy Minister of Agriculture for Management and Financial); Dr. Dhia Al-Deen Al-Qureashy (Prime Minister Advisor); Mr. Manaf Al-Saigh (Advisor Public Policy); Mr. Salim P. Ibrahim (Consultative Administrative and Financial Affairs); Mr. Miraq Aljubouri (Senior Specialist - MSI); and, Michael Schaeffer (PFM Team Leader) at the Ministry of Agriculture's HQ.

Prelude Discussion to Presentation

2. **Prior to the presentation, there was a brief introductory discussion.** In brief, the ComSec Public Fiscal Reform Budget Committee's mandate is:

- Review various international budget modalities.
- Provide recommendations of a suitable budget modality to be adopted by Iraq.
- ComSec Committee is expected to take a number of months to review various budget modalities, and international experiences and come up with a recommendation by end-2013.
- Various committee members expressed an apprehension with respect to program budgeting, stating that:
 - This budget modality was considered outdated;
 - They expressed in interest in what is commonly called zero-based budgeting.

General Description of the Presentation

3. **During this meeting Tarabot's PFM advisors provided a general overview of various budget modalities, including but not limited to: 1) Pros and cons of line-item and zero based budgeting; 2) International Experiences on Program Budgeting (France, Canada); 3) Prerequisites for developing a national program budget modality; and 4) Establishing program budgets and its implications for the near and medium term.**

Line-item budget (Pros and Cons)



- Traditional manner of formulating budget by economic category. However, the analysis of the budget is relatively simple, and budget changes are gradual.
- Says nothing about spending objectives, expenditure priorities, or linking of expenditures to outputs.
- Line-item budget traditional focuses on inputs not outputs or service delivery.

Zero Based Budgeting (ZBB)

- Zero based budgeting involves costing each activity from the beginning (every year). It is not based on an incremental budgeting approach, and previous budget figures are not adopted as the base. Zero is taken as the base year and the budget is developed on the basis of likely activities for the future period. The fact that resources have already been granted to a program does not mean that it should be continued.
- Zero Based Budgeting was used by the U.S. at the national level during the 1970s but was discontinued because it was simply impossible to undertake each year for the preparation of the annual budget. In effect, zero based budgeting is far too complex to undertake for annual budget submissions.
- At present, a modified ZBB approach is used but only under what is known as public expenditure reviews (PERS), where individual programs are reviewed to determine their effectiveness and re-costed.

Program Budgeting

- The discussion on programs presented two variants – France and Canada. In brief, virtually all models of program budgeting are variants of a similar underlying modality:
 - Programs are usually the top level of a hierarchy;
 - Sometimes programs are at the highest policy level (i.e. France and its Missions);
 - Most countries use 2-3 levels of hierarchy (programs, sub-programs, activities), because it is easier to cost and more readily tracked.
- Program budgeting structures and their various modalities are the most widely (common) structure in national and subnational budget systems.
- Emerging issues under program budgeting, include:
 - Changes in responsibility for managers;
 - Changing roles and responsibilities for MoF and line-ministries;
 - Program budgeting (and, the capacity building that is required) is: 1) time consuming; 2) requires more information than the traditional budget; 3) is costly to implement; and 4) requires substantial capacity building (in addition to a functional financial management system).
- Implications for the near and medium term. Program budgeting requires: 1) legislative reforms (with appropriations being accommodated at the program level) and, repositioning of budget control levels; 2) Accounting and IT reforms:- Budgetary classification and chart of accounts will need to be modified to take into account programs and activities; 3) Auditing:- internal and external audits must develop capacity for undertaking performance audits.

Comments and Next Steps



- The ComSec Budget Committee convenes on a regular basis. The next meeting is TBD.
- The Committee would like to engage in follow-up discussions to learn more about the various budget modalities, and have requested whether we can assist in designating various country specific examples for them to visit (and, ask questions).
- There appears to be a general ill-informed understanding as to what Zero-Based Budgeting actually is (and, why it would be difficult) to implement it in Iraq. However, one of the members who is a proponent of zero based budgeting (ZBB) now has at least a passing understanding that ZBB concepts can be used under the general umbrella of public expenditure reviews (PERs).

February 10, 2013

To: Nael Shabaro
Claire Pullon

From: Michael Schaeffer
PFM Advisor

Re: **2013 Indicative Work-plan Public Financial Management (PFM) Team**

I. Introduction

1. This Public Financial Management team 2013 work-plan is structured along the following key objectives:

- a. Assist the GOI to develop multi-year budgets that are linked to the National Development Plan;
- b. Assist key ministries to improve the comprehensive of their budgets; and,
- c. Assist key ministries to improve their budget predictability and budget control.

Means of Achieving Objectives

2. To address the issue of aligning ministerial budgets to the National Development Plan Tarabot technical assistance at the national level will:

- Assist in the preparation of: **indicative medium term budget framework submission forms and draft” Medium Term Expenditure Framework Guidelines.** Tarabot technical assistance will work with ministries to prepare and present a medium term (3-year) budget.

3. To address the issue of budget predictability and budget control Tarabot technical assistance at the national level will work with ministries:

- To **improve cash flow plans** that are more closely linked to the ministry procurement plans (for 3-5 ministries).

II. Focusing on Medium Term Expenditures at the Sectoral Level (Strategic Budgeting)

Why is this reform important?

4. In fiscal management, the cost of a policy in the next year is not always a good indication of its costs over time. For example, capital expenditures for a new school in one year can lead to a need for additional operating expenditure in the future. While the Budget Law currently requires the focus be on the annual budget, it should be recognized that governments need to understand and make provision for future expenditure policies (3 to 5 years). To be

implemented, this requires a ‘bottom-up’ assessment of the medium term cost of existing policy and ‘forward estimates’ as part of a medium term budget framework.

Challenges:

- a. **Establishing a smooth linkage to the macro-fiscal unit:** The macro-fiscal unit in the Ministry of Finance is the cornerstone in attempting to develop a medium term fiscal framework (MTFF) to guide the preparation of the budget. The work is analytically demanding and in the Iraqi context has proven to be a challenge.
- b. **The development of sectoral forward estimates as part of an MTBF is resource intensive.**
- c. **Ensuring that the preparation of forward estimates focuses on both the recurrent and capital budgets.** Identifying the future recurrent implications of current capital expenditures is one of the more important elements of forward estimates, but it is also important to identify changes in recurrent expenditure needs that are not directly linked to projects.

MTBF in the 2013 Work-plan

5. As provided from above, the Medium Term Budget Framework refers to fiscal budget planning for the present and two following years. Tarabot PFM advisors will assist the three-to five core line ministries **to prepare indicative medium term budget frameworks.** The technical assistance provided includes:

- a. The preparation of:
 - i. Indicative MTBF Budget Submission Forms;
 - ii. ‘Draft’ Medium Term Expenditure Framework Guidelines; and,
 - iii. Draft ministerial level MTBF (for three ministries to be determined) including identifying required activities and outputs that will be produced; and, planning and cost of the inputs required to implement the activities.
- b. Training workshops on preparing medium term budgets;

Expected output

6. The most recent Public Expenditure Financial Assessment (PEFA) (2008) scores for Iraq with respect to medium term strategic budgeting are as follows:

Performance Indicator -12 (D+)

- (iii) Existence of sector strategies and multi-year costing of recurrent and investment expenditure (D);
- (iv) Linkages between investment budgets and forward expenditure estimates (D)



- **By integrating the management of operating and capital expenditures in the budget over a medium term budget framework, the quality of total government expenditure performance and reporting can be improved.**
- **As such, the expected output will be 3-5 ministerial medium term budget frameworks.**
- **When/ IMF/WB reviews PI-12, PEFA scores should show marked improvement.**

Timeline for Deliverables

- Three to five ministries with Medium Term Budget Framework (MTBF) developed and submitted by end-2013.
- Line Ministry budgets aligned to the national development strategy.

III.Improving Cash Flow Plans

7. As present from above, to improve budget predictability and to improve budget execution, cash flows tightly aligned to procurement schedules are essential.

8. Why is this reform important?

9. The most recent Public Expenditure Financial Assessment (PEFA) (2008) scores for Iraq with respect to medium term strategic budgeting are as follows:

Expected output

PEFA Performance Indicator-16 (C)

- (i) Extent to which cash flows are forecast and monitored (C);
- (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings and expenditure commitments (D);

- **By improving line ministry cash flow plans in-year information as to budgeted expenditures versus actual will significantly improve, and there will be reduction in monthly budget execution variance.**
- **Tarabot will review current budget execution variance and measure against future output variance.**
- **PEFA scores should indicate significant improvement.**

Timeline for deliverables

- Three-to-five ministries with annual cash flow plans developed, incorporating procurement plans, seasonal and economic variations by end-2013.



Iraq Public Expenditure and Institutional Assessment

Volume 2

Public Expenditure and Financial Accountability (PEFA) Assessment Public Financial Management Report

June 2008

Middle East and North Africa Region
Social and Economic Development Group



Document of the World Bank

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ABBREVIATIONS AND ACRONYMS

AGA	Autonomous Government Agency
BSA	Board of Supreme Audit
CCCI	Central Criminal Court of Iraq
COI	Commission of Integrity
CPA	Coalition Provisional Authority
CSR	Civil Service Reform
DFID	Department for International Development
FML	Financial Management Law
GoI	Government of Iraq
IG	Inspector General
IDA	International Development Association
IFMIS	Iraq Financial Management Information System
MDA	Ministries, Departments and Agencies
MENA	Middle East and North Africa
MoE	Ministry of Education
MfF	Minister for Finance
MoF	Ministry of Finance
MoHC	Ministry of Housing and Construction
MoO	Ministry of Oil
MoP	Ministry of Planning
OFFP	Oil For Food Program
PEFA	Public Expenditure and Financial Accountability
PEIA	Public Expenditure and Institutional Assessment
PFM	Public Financial Management
USAID	United States Agency for International Development
UST	United States Treasury

**PUBLIC EXPENDITURE AND FINANCIAL ACCOUNTABILITY (PEFA) ASSESSMENT
PUBLIC FINANCIAL MANAGEMENT REPORT**

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Overview of the Indicator Set

A. PFM-OUT-TURNS: Credibility of the budget		Score
PI1	Aggregate expenditure out-turn compared to original approved budget	D
PI2	Composition of expenditure out-turn compared to original approved budget	C
PI3	Aggregate revenue out-turn compared to original approved budget	A
PI4	Stock and monitoring of expenditure payment arrears	D
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency		
PI5	Classification of the budget	C
PI6	Comprehensiveness of information included in budget documentation	D
PI7	Extent of unreported government operations	D+
PI8	Transparency of inter-governmental fiscal relations	D
PI9	Oversight of aggregate fiscal risk from other public sector entities.	D
PI10	Public access to key fiscal information	D
C. BUDGET CYCLE		
C(i) Policy-Based Budgeting		
PI11	Orderliness and participation in the annual budget process	C
PI12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+
C(ii) Predictability and Control in Budget Execution		
PI13	Transparency of taxpayer obligations and liabilities	B
PI14	Effectiveness of measures for taxpayer registration and tax assessment	C
PI15	Effectiveness in collection of tax payments	D+
PI16	Predictability in the availability of funds for commitment of expenditures	C+
PI17	Recording and management of cash balances, debt and guarantees	C
PI18	Effectiveness of payroll controls	D+
PI19	Competition, value for money and controls in procurement	D+
PI20	Effectiveness of internal controls for non-salary expenditure	D+
PI21	Effectiveness of internal audit	D+
C(iii) Accounting, Recording and Reporting		
PI22	Timeliness and regularity of accounts reconciliation	C+
PI23	Availability of information on resources received by service delivery units	D
PI24	Quality and timeliness of in-year budget reports	D+
PI25	Quality and timeliness of annual financial statements	D+
C(iv) External Scrutiny and Audit		
PI26	Scope, nature and follow-up of external audit	Not Rated
PI27	Legislative scrutiny of the annual budget law	D
PI28	Legislative scrutiny of external audit reports	D
D. DONOR PRACTICES		
D-1	Predictability of Direct Budget Support	D
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	D+
D-3	Proportion of aid that is managed by use of national procedures	D

Summary Assessment

(i) Integrated assessment of PFM performance

1. Using a four-point rating scale, the assessment produces the following results summarized in Table 1.

Table 1: Abbreviated Summary of PEFA Indicator Scores

PEFA Score	Number of Indicators
A	1
B	1
C	8
D	20 (note 1)
Not Rated	1 (note 2)
Total	31 (note 3)

Note 1 – includes the 3 donor indicators that form part of the PEFA framework.

Note 2 – due to inadequate information

Note 3 – comprises 28 system indicators and 3 donor indicators

2. **The large number of performance indicators awarded the lowest possible score (D) indicates that there is scope for substantial improvement in many priority aspects of the Iraqi national PFM system.** The analysis suggests that reform is required in the following areas:

- **Budget Credibility (PI-1 to PI-4)** – aggregate expenditure out-turns have repeatedly shown significant variances from budget and better monitoring of expenditure payment arrears is required
- **Comprehensiveness and Transparency (PI-5 to PI-10)** – there is a significant level of unreported government operations and weak oversight of fiscal risk arising from the activities of other public sector entities
- **Policy-Based Budgeting (PI-11 and -12)** – a multi-year perspective in financial planning and budgeting is largely absent
- **Predictability and Control in budget execution** – tax collection procedures need to be strengthened, payroll controls are weak, procurement procedures lack competition and inadequate controls and weaknesses exist in internal audit
- **Accounting, Recording and Reporting (PI-22 to PI-25)** – resources received by service delivery units are often problematic and there are deficiencies in the quality and timeliness of annual financial statements
- **External Scrutiny and Audit (PI-26 to PI-28)** – weaknesses exist in terms of timely submission of audit reports to the Council of Representatives and follow-up on audit recommendations.
- **Donor Assistance (DI-D3)** – donors do not perform well against the PEFA indicators in that the financial information they provide is untimely, incomplete and not delivered in line with the GoI's budget cycle or in a breakdown consistent with the Government's classification system. In addition, national procedures are bypassed for almost all development assistance projects and programs.

(ii) Assessment of the impact of PFM weaknesses

3. **PFM systems have three objectives: macro-fiscal discipline, strategic allocation of resources, and operational or technical efficiency.** These three

objectives are linked. Fiscal discipline is the basis without which neither a strategic allocation of resources nor operational efficiency is possible.

4. **The findings of the strengths and weaknesses of the current PFM system in Iraq** have the following implications in terms of these three objectives.

Macro-fiscal discipline

5. **In recent years, high world oil prices have enabled the Government of Iraq (GoI) to generate much higher revenues than budgeted.** Consequently, the GoI has experienced no difficulty in financing a growing level of public expenditure but has in fact been able to accumulate significant reserves of foreign currency through its budget surpluses. As long as oil prices remain buoyant, maintaining macro-fiscal discipline will pose few problems, but measures need to be taken to contain recurrent expenditure and achieve a higher level of capital investment budget execution.

Strategic allocation of resources

6. **Strategic resource allocations in Iraq suffer from the lack of a medium term perspective to budgeting and financial planning.** Although a strategic medium term fiscal perspective exists in conjunction with the International Compact for Iraq (ICI), it is difficult to see the connection between this and annual resource allocations. Budgeting continues to be primarily an annual exercise. The problem is compounded by the lack of effective integration between the recurrent and investment budgets both at the aggregate level and at the sectoral level.

Operational efficiency

7. **A major issue in Iraq over the last three years has been the low capital investment budget execution rate which has prevented the effective development of essential public services.** The difficult security situation has clearly been an important factor but there are also systemic PFM issues associated with budget formulation and implementation. Whilst at times there have been problems with the release of allocations that have limited the accessibility of budget funds to ministries and governorates, there is also a major issue in terms of the inefficient use of funds that have been released but remain idle in the bank accounts of spending units.

(iii) Prospects for reform planning and implementation

8. **The strategic context for a PFM reform process has been set by the International Compact for Iraq (ICI).** This provides a firm foundation for a Government-led reform process that can be supported in a sustained and integrated manner by Iraq's international development partners. As a basis for monitoring progress, detailed actions are set out in the Joint Monitoring Matrix (JMM) that supports the ICI. One major component of the JMM concerns the effective management of public resources in the interests of the people of Iraq.

9. **Within this component, the GoI commits itself to the objective of aligning Iraqi PFM and procurement system with sound international practice.** In order to establish the analytical framework within which PFM reform can take place, the GoI has been working as a priority action with the World Bank to complete the Public Expenditure and Institutional assessment (PEIA) to evaluate the performance of the national PFM system as a basis for prioritization of PFM reform programming.

10. **A range of international organisations has been providing support to PFM reform and capacity development over the last three or four years.** These include the International Financial Institutions, the United Nations, the United States, the United Kingdom and the European Commission. Much of the multilateral aid has been channeled through the International Reconstruction Fund Facility for Iraq (IRFFI). The US Government has worked on a number of PFM issues through the US Treasury, US Agency for International Development (USAID), State Department and Department of Defense, while the UK Government through its Department for International Development (DFID) has been actively involved in supporting economic and financial management. The UNDP has managed a program of support to the Board of Supreme Audit as well as providing support to anti-corruption initiatives. The World Bank has provided a number of workshops on specific aspects of PFM. The IMF has been providing technical assistance in support of its Stand By Facility. The need now is to co-ordinate these initiatives under a coherent program of support to a GoI led PFM reform strategy and action plan.

11. **In designing such a program, careful attention need to be paid to the unusually difficult circumstances that face a fragile state like Iraq which has been so severely affected by conflict since 2003.** Many crucially important public institutions have been devastated by the destructive effects of war and insurgency on their capacity. Large numbers of key staff have been lost to the Iraqi public service. A sustained effort over the medium term backed by Iraq's international development partners will be necessary to rebuild the capacity required for a well performing PFM system. This will require appropriate incentives to help create an enabling environment for PFM modernization.

Introduction

Objective of the PFM-PR

12. **The purpose of the PEFA assessment is to document the results of a joint effort** between the Government of Iraq and the World Bank, supported by the Governments of the United Kingdom and the United States to develop an objective assessment of the Iraq's Public Financial Management (PFM) systems.

Process of preparing the PFM-PR

13. **The Iraqi national PFM system has been assessed jointly by the Government of Iraq (GoI) and the World Bank, with support from the UK and USA, using the framework developed under the Public Expenditure and Accountability (PEFA) Program.** A number of activities have contributed to the data collection and analysis that underpin the assessment. Most notably, ten workshops were held between July and November 2007 in Baghdad. The workshops covered the key dimensions of a PFM system: i) Budget Credibility, ii) Accounting, Recording and Reporting, iii) Financial Management Information Systems, iv) Comprehensiveness and Transparency, v) Procurement, vi) Policy based Budgeting and Predictability in Budget Execution, vii) Accounting Frameworks, viii) Control in Budget Execution, ix) External Scrutiny and Audit and Donor Practices, and x) Capital Investment Budgeting.” Other workshops forming part of the PEFA process have taken place in Amman, Jordan.. These have

included two workshops with the top management of the national and Kurdish Boards of Supreme Audit.

14. **The main GoI partner in the assessment is the Ministry of Finance (MoF).** In addition, several other government agencies have also played an active part in the work. These include the Board of Supreme Audit (BSA), the Ministry of Planning (MOP), the Ministry of Education (MoE) and several of the Inspectors General (IGs).

15. **This assessment is an integral part of the World Bank's Public Expenditure and Institutional assessment (PEIA),** a major piece of analytical work that is designed to pave the way for a comprehensive PFM reform program supported by the Bank and other donors.

Methodology

16. **The PEFA methodology is set out in the Public Finance Management Performance Measurement Framework (available in various languages at www.pefa.org).** It is based on 28 indicators covering a country's PFM system, and 3 indicators addressing the interaction of donors with a country's budget process and PFM system. PEFA assessments provide a snapshot picture of the effectiveness of PFM systems at a particular point in time and therefore provide a good basis for measurement of their improvements over time. They do not provide, however, for an in-depth analysis of the causes of existing weaknesses. This is provided in the accompanying volume of the PEIA.

17. **Each indicator is scored on a scale from A to D. The basis for these ratings is the minimum requirements set out in the methodology.** Many indicators include two or more dimensions, which are scored using methods M1 or M2. For method M1 the weakest link is decisive, i.e. the overall rating is based on the dimension with the lowest score. For M2 an average of the sub-ratings is used to arrive at the score for the overall indicator (see the PEFA Framework, "Scoring Methodology").

Scope of the assessment

18. **The PEFA assessment focuses primarily on the national level of a country's PFM system.** At the national level, it seeks to cover the entire PFM system, including cross-cutting and overall issues, the revenue side, the budget cycle from planning through execution to control and auditing; and the interaction of development partners with the PFM system. Some of the indicators are designed to probe into how the national level interacts with sub-national governments and with public service providers at the local level as well as the financial relationships with public enterprises.

Country Background Information

Description of country economic situation

19. **Iraq is one of the world's largest producers of oil, exports of which dominate the country's economy and public finances.** It has suffered politically and economically since the early 1990's first as a result of the isolation of the regime from the international community, then through the turmoil and insecurity that has engulfed the country since the arrival of international armed forces in April 2003. There are signs that the country may be starting to emerge from the worst of these troubles, but a great deal needs to be done to revitalize economic, political and social institutions.

Economic situation

20. **The Executive Board of the International Monetary Fund (IMF) recently approved a successor Stand-By Arrangement (SBA) for Iraq for an amount equivalent to SDR 475.36 million (about US\$744 million).** The previous SBA had been approved by the IMF's Executive Board on December 23, 2005. The successor arrangement is designed to support Iraq's economic program over the next 15 months through March 2009. As before, the funds can only be drawn down in the event of an emergency.

21. **Despite difficult political and security conditions, the GoI was successful in keeping its economic program on track in 2006-07.** Inflation fell sharply, reflecting the GoI's tough monetary and fiscal policy stance and the appreciation of the dinar. Direct budgetary fuel subsidies were eliminated, except on kerosene, and private fuel imports liberalized. The recently enacted amendments to the pension law have made the pension system fiscally sustainable. Efforts have been made to operationalize a new chart of accounts and budget classification system and the payments system has been modernized.

22. **Despite showing signs of improvement in recent months, the security situation remains a major obstacle for investment and reconstruction, hampering oil production and economic growth.** In addition, much remains to be done to modernize financial management of the government and the central bank, and to reform the banking system.

23. **In 2008, the GoI aims to allocate resources towards investment, including in the oil sector, and to improve the provision of public services, while containing current government spending, notably on the wage and pension bill.** The program—which envisages an increase in economic growth, a further reduction in inflation, and an increase in net international reserves—will also encompass priority structural reforms, including actions to strengthen administrative capacity and governance.

24. **The Central Bank of Iraq (CBI) will continue to strengthen its accounting and reporting framework.** The central bank also aims to expand the coverage of the payments system, strengthen the supervisory framework for commercial banks, and adopt reserves management guidelines. The GoI has made a significant effort to settle arrears and conclude debt agreements with private and official creditors are commendable. However, further progress is needed to resolve the remaining non-Paris Club claims.

25. **The 2008 program envisages an increase of oil output to 2.2 mbpd, and overall GDP growth to reach 7 percent.** Annual consumer price inflation is targeted to decline to 12 percent.

26. **The 2008 government budget makes room for sizable investment while maintaining fiscal sustainability and the continued avoidance of direct fuel subsidies.** Improving project implementation, facilitated by greater local participation and reduced bureaucracy, will be a central aim of the GoI, but progress is likely to

continue to be uneven and patchy. On the recurrent expenditure side, spending on the Iraqi security forces and public sector remuneration are expected to continue to grow rapidly, causing total expenditure to rise by an annual average over the period 2008-09. This growth in spending will be mitigated, however, by the removal of most fuel subsidies that was implemented in June 2007. Overall, large fiscal surpluses will continue, increasing from an estimated US\$ 14 billion in 2007 to perhaps \$20 billion in 2008.

Description of budgetary outcomes

Fiscal performance

Central Government Budget (as % GDP)			
	2004	2005	2006
Total Revenue	79.6	107.4	80.4
- Own Revenue	70.5	79.5	67.9
- Grants	9.1	27.9	12.5
Total expenditure	120.7	96.5	69.4
- Non-interest	119.8	96.3	68.8
- Interest	1.0	0.2	0.6
Aggregate deficit (incl. grants)	-41.2	10.9	11
Primary Deficit	-40.2	11.1	11.6
Net financing - external	41.2	5.9	-5.4
-internal	-1.4	-10.4	-3.9

Allocation of Resources

Actual budgetary allocations by economic classification (% total expenditure)			
	2004	2005	2006
Current Expenditure	81.6	79.9	75.5
- Wages and salaries	7.7	14.7	16.7
- Pensions	2.3	6.2	5.2
- Goods and services	36.7	41.0	33.4
- Interest Payments	0.8	0.2	0.9
- Transfers	31.1	14.0	14.9
-Other	3.0	3.9	4.4
Capital Expenditure	18.4	20.1	24.5

Source: IMF SBA Brief

Description of the legal and institutional framework for PFM

27. **Having been devastated by conflict during the past 5 years, Iraq's institutional arrangements for PFM have become the subject of considerable uncertainty and volatility.** New organizations have been created and significant changes have been made to the legal and regulatory framework without the full understanding and acceptance of those public officials responsible for managing the country's public finances.

28. **The key recent law is the Financial Management Law and Public Debt Law (Order Number 95 of the Coalition Provisional Authority) of 2004.** The law emphasizes the principles of transparency, comprehensiveness and unity (the latter requiring that all government resources be directed to a common pool to be allocated

and used for public expenditure according to the priorities of the government). Although this is a generally sound piece of legislation, there are in practice difficulties with its application due to the lack of awareness, understanding and, in some quarters, acceptance of the changes it introduced vis-à-vis previous practice.

29. **Primary responsibility for PFM rests with the Ministry of Finance, although important roles are also played by the Ministry of Planning (in relation to the capital investment budget), the Board of Supreme Audit (in relation to the external audit of the public sector and accounting standards) and the Inspectors General (internal audit in government departments).** The Council of Representatives (the Iraqi Parliament) is also seeking to strengthen its contribution to effective PFM through enhanced budget scrutiny facilitated by a proposed budget office. Iraq’s constitutional commitment to a federal state has led in the last two annual budgets to far greater decentralization of public spending to sub-national government in the form of the governorates and the Kurdistan Regional Government (KRG). Outstanding issues in the KRG concern the completion of merging two administrations, including the Ministry of Finance and Board of Supreme Audit.

Assessment of the PFM Systems, Processes and Institutions

Budget credibility

30. **The credibility of the budget is important to various users of government financial information, including the general public, civil society, domestic and foreign investors, parliament and government officials who are responsible for implementing the budget.** A budget is deemed to be credible if the differences between the actual revenues and expenditures for the budget period and the originally approved estimates are relatively small. These differences measure the budget variance, which is a good measure of the overall performance of the PFM system at a high level. This comparison is the basis of PI1 of the PEFA Framework.

PI 1: Aggregate expenditure out-turn compared to original approved budget

PI 1	Scoring method M1: In (two or) all of the last three years the actual expenditure exceeded the initially budgeted amount by more than 15% of budgeted expenditure.	D
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Aggregate expenditure outturn compared to the original approved budget for 2004-2006 is shown in Table 1 below.

Table 1: Aggregate expenditure out-turn compared to original approved budget (in billion Iraqi dinars)

	Budget Out-turns			FY Change	
	2004	2005	2006	2004-05	2005-06
Budget					
Revenue	19,259	28,959	45,392	50%	57%
Expenditure	20,286	35,996	50,963	77%	42%
Budget Surplus (+)/Deficit (-)	-1,028	-7,037	-5,571	585%	-21%
Estimated Actuals					
Actual Revenue	26,594	36,656	49,264	38%	34%
Actual Expenditure	28,821	26,453	34,590	-8%	31%
Actual Surplus (+)/Deficit (-)	-2,227	10,203	14,674	-558%	44%
% Overshot (+)/Undershot (-) forecast					
Revenue	38%	27%	9%	-30%	-68%
Expenditure	42%	-27%	-32%	-163%	21%
Deficit	117%	-245%	-363%	-310%	48%

Source: Ministry of Finance

31. The data in above table shows large aggregate budget variances on expenditure, a high level of overspending in 2004 having been reversed in 2005 and 2006, when major under-spending, mainly in the capital investment budget occurred. Capital budget implementation was very limited in 2005 and 2006, with execution rates as low as 23% and 25% respectively. On the basis of unconfirmed figures, the situation was much better in 2007 when the capital budget execution rate may have reached 66%. While this improvement is welcome, there is still much to be done to improve investment budget performance. Table 2 below gives more detailed information on the investment budget.

Table 2: Functional Analysis of Capital Investment Expenditure

Functional Head	2007			2006			2005		
	Original Budget	Forecast - Oct 07	Deviation	Original Budget	Est Actual	Deviation	Original Budget	Est Actual	Deviation
Oil	2,875	1,754	39%	4,657	214	95%	4,500	165	96%
Regions' Development (excl KRG)	2,623	828	68%						
Kurdish Region	2,013	2,013	0%	750	790	5%	750	772	3%
Electricity	1,745	1,733	1%	1,741	401	77%	440	214	51%
Public Works	558	422	24%	552	122	78%	252	101	60%
Health	431	22	95%	50	26	49%	60	27	55%
Housing & Construction	383	191	50%	312	136	56%	365	101	72%
Education	366	21	94%	28	24	15%	100	2	98%
Water Resources	330	267	19%	300	137	54%	276	180	35%
Higher Education	259	51	80%	60	23	61%	50	11	78%
Communications	193	108	44%	248	1	100%	200	-	100%
Labour and Social Affairs	141	68	52%	20	8	60%	27	10	63%
Transportation	133	28	79%	154	6	96%	145	23	84%
Baghdad Municipality	120	55	54%						
Planning	100	41	59%	38	36	6%	45	1	98%
Agriculture	63	17	73%	36	3	91%	26	1	96%
Defence	60	7	88%	500	304	39%	-	-	0%
Interior	50	5	89%	100	10	90%	-	-	
Industry and Minerals	42	50	20%	16	10	36%	14	13	9%
Youth and Sports	38	25	34%	386	264	32%	176	110	37%
Remainder	188	53	72%	968	403	58%	449	225	50%
Total expenditure deviation	12,710	8,371	34%	9,963	2,522	75%	7,495	1,732	77%
Composition variance	12,710	8,371	44%	9,963	2,522	75%	7,495	1,732	78%

Source: MoF for 2005 and 2006 and MoP for 2007 – data for 2007 is not verified and essentially release data

PI 2: Composition of expenditure out-turn to original approved budget

PI 2	Scoring method M1: Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 per cent in no more than one of the last three years	C
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32. For a government budget to be a useful policy statement, it is necessary for the composition of actual expenditure to be close to the original budget. Table 3

shows the variance in expenditure composition of the Iraqi national budget for the last three years. It is supported by detailed calculations in Attachment 1. Only in one year (2006) was the weighted average of the variance in excess of the total deviation (cf. PI 1) greater than the threshold of 10%; the merits a score of C. Since the situation has been improving over time, an upward arrow is included in the score. The comparisons are shown for all heads of expenditure and for the largest ten heads; the resultant score is the same.

33. **The score indicates that reallocations between budget administrative lines (i.e. ministries) have not significantly contributed to the variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure.** This essentially means that a ministry’s overall budget has not been adversely affected by in-year reallocations between ministries. However, it will be interesting to see the effect in 2007 of the reallocations that took place in the mid-year review. This has reallocated funds away from those ministries whose capital budget expenditures fell significantly short of their allocation as at the mid-year point.

Table 3: Variance in expenditure composition of State Budget

Year	For PI-1		For PI-2	
	Total exp. Dev	Total exp. Var (composition)	Var in excess of total dev.	
All Functional/Administrative Heads				
2004	42.1%	54.4%	12.3%	
2005	26.5%	30.2%	3.7%	
2006	32.1%	33.0%	0.9%	
10 Largest Functional/Administrative Heads				
2004	38.7%	50.6%	11.9%	
2005	26.0%	29.2%	3.2%	
2006	31.0%	32.0%	1.0%	

PI 3: Aggregate revenue out-turn compared to original approved budget

PI 3	Scoring method M1: Actual domestic revenue collection was well above the defined threshold of 97% in all of the past three years.	A
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34. **Over the last three years, aggregate revenue out-turn did not go below 97% of budget revenue forecasts, thus scoring an A - the highest possible score.** This reflects both the Government’s prudential revenue forecasting approach as well as the unanticipated sustained increase in the world price of oil, which effectively began in 2004. As Table 4 below shows revenue out-turns have consistently overshoot forecasts, although accuracy of annual forecasts have been improving..

Table 4: Aggregate Revenue Performance

Year	For PI-3		
	Total rev. dev.	Total rev. var (comp'n)	Var in excess of total dev.
2004	38.1%	41.9%	3.8%
2005	26.6%	35.4%	8.9%
2006	8.5%	16.2%	7.7%

35. **Given Iraq's dependence on oil revenues, it is unsurprising that the positive revenue budget variances are essentially the result of the surplus of actual oil prices over budgeted prices over the last three years. This aspect more than outweighs the fact that oil exports have been lower than forecast. Table 5 contains the relevant data.**

Table 5: Oil Export Revenues

	2004	2005	2006
Oil Revenue forecasts			
Price /bl (US\$)	21.00	26.00	46.61
Export Producton mbl/d	1.6	1.8	1.7
Forecast (US\$ m)	12,264	17,082	28,071
Forecast (ID b)	18,396	25,623	42,106
Oil Revenue out-turns			
Price /bl (derived)	33.04	44.22	53.26
Export Producton mbl/d	1.4	1.4	1.5
Out-trun (US\$ m)	16,884	22,597	29,161
Out-turn (ID b)	25,326	33,896	43,741
Oil Revenue out-turns: deviations			
Price	57.3%	70.1%	14.3%
Export Producton	-12.5%	-22.2%	-9.1%
Revenue Out-turn	37.7%	32.3%	3.9%

PI 4: Stock and monitoring of expenditure payment arrears

PI4	Scoring method M1: (i) The stock of arrears is unlikely to exceed 10% of total expenditure (Not rated) (ii) There is no reliable data on the stock of arrears from the last two years. (D)	D
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36. **The absence of reliable data on the stock of arrears from any of the last three years makes it impossible to award a score higher than D to this indicator.** Due to the agreements made with Paris-Club and non-Paris Club creditors, there are no arrears on debt servicing for reconciled debt. However, Iraq does not utilize any standard form of commitment accounting nor are there adequate systems in place to track expenditure arrears. Given the absence of data it is not possible to estimate the level of arrears with a high level of confidence.

37. **Iraq has a strong history of centralized controls in budget execution, which has likely prevented any substantial build up of uncontested arrears.** Given the historical practice by Government officials to commit public resources only when funds are available and only when approvals have been provided at various levels, the stock of arrears is likely to be low. For the second dimension, there is no reliable data on the stock of arrears from the last two years nor has there been any comprehensive ad hoc exercise to estimate the stock of arrears within the last two years. Hence, a score of D is given.

38. **There are anecdotal reports that payments from letters of credit are taking an unreasonable amount of time.** While payments of letters of credit (L/C) increased significantly from US\$2.6b in 2004 to US\$8.4b 2006, the stock of L/Cs have plateaued at around US\$3b (see Table 9). The 2006 stock represents approximately 14% of actual expenditure, however, it is understood that most of the stock is held on behalf of the oil and trade ministries and that any unpaid amounts are awaiting evidence of completion. Consequently, for the purpose of this indicator, letter of credit based arrears is unlikely to have a significant impact on the total stock of arrears.

39. **Overall, the originally approved GoI is a rather reliable instrument of government policy.** Revenues have been consistently exceeding budgeted amounts by

a significant margin, whereas actual expenditure, especially on capital investments, has consistently been well below budget. The inevitable consequence has been large budget surpluses in the last two years, leading to a big increase in the stock of cash reserves in the Development Fund for Iraq, held in New York. Table 6 below summarises the growth of cash balances.

Table 6: GoI Cash Flow and Balances: 2004-2006 (US\$m)

	2004	2005	2006
DFI Cash Flow Balance	4,923	1,360	2,327
MoF Cash Flow Balance	-	1,008	278
Minsitries Cash Balances	tba	tba	tba
GoI Stock of Cash Reserves	4,923	7,291	9,895

Source: IAMB Audits

Comprehensiveness and transparency

PI 5: Classification of the budget

PI 5	Scoring method M1: The budget formulation and execution is based on administrative and economic classification using GFS standards	C
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40. **GFS-based economic classifications are now being used during Budget formulation** in addition to primary administrative classifications. Consequently, a score of C is appropriate (see Table 7). Budget execution accounting systems used by ministries and governorates are, however, currently using the legacy Chart of Accounts (CoA). These are subsequently mapped to the GoI’s new GFS-based classification system by the MoF in Baghdad.

Table 7: Scoring for Indicator 5: Budget Classification

<u>Budget Formulation</u>	<u>Budget Execution</u>	<u>GFS/COFOG Classification Standards</u>
Yes	Yes	Administrative
Yes	Yes	Economic
No	No	Sub-functional
No	No	Sub-programs mapable to sub-functional
No	No	Functional
Score	Score	Overall Score
C	C	C

PI 6: Comprehensiveness of information included in budget documentation

PI 6	Scoring method M1: Share of the information listed below in the budget documentation most recently issued by the Government: only 2 of the 9 information benchmarks fully met	D
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41. **The assessment examines which of nine pieces of “good practice” information are included in the budget documentation submitted to the Parliament.** In Iraq, four of these are included in the GoI budget papers, but they tend to be partial rather than complete (for example, key budget tables are frequently missing). These four elements are: i) key macroeconomic assumptions; ii) fiscal balance; iii) consistent reporting of current and budget year; and iv) summarized data for revenue and expenditure (see Table 8). Given the partial nature of some of the information a score of “D” is appropriate.

Table 8: Documentation Elements in the 2007 Annual Budget Papers

Budget Documentation Elements	Included	Comments
1. Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate.	Yes	Oil price, production and exchange rate assumptions only. Inflation and growth assumptions partial.
2. Fiscal deficit, defined according to GFS or other internationally recognized standard.	Yes	Investment inflows (loans for investment) not calculated
3. Deficit financing, describing anticipated composition.	No	Partial. Note letters of credit issue. Description of loan financed projects supported by development partners - but does form part of the consolidated budget.
4. Debt stock, including details at least for the beginning of the current year.	No	Absent. Note letters of credit
5. Financial Assets, including details at least for the beginning of the current year.	No	Absent
6. Prior year’s budget outturn, presented in the same format as the budget proposal.	No	Absent
7. Current year’s budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.	Yes	Revised budget provided. Estimated actuals not provided.
8. Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year.	Yes	Summarised data provided
9. Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.	No	Only general descriptions provided. Estimates of budget impact of major new policy absent.
	Score	C

42. **While oil forecast assumptions are provided, other macroeconomic assumptions presented have limited usefulness** as these are not used in a medium-term fiscal or macroeconomic framework, nor are they utilized by budget holders in the formulation of budget submissions. Key elements missing in the budget papers include: i) deficit financing tables, ii) debt stock; iii) financial assets, iv) prior year’s budget outturn; and iv) new policy budget implication tables. While budget papers refer to cash reserves and carryovers as financing the budget deficit, the composition and presentation is insufficient. Estimates of carryovers, outstanding letters of credits and other cash reserves should be provided. Comprehensiveness would also require that barter transactions and loans be reflected in the financing table associated with a consolidated budget

PI 7: Extent of unreported government operations

PI 7	<p>Scoring method M1: (i) The level of unreported (other than donor funded projects) constitutes more than 10% of total expenditure.(D) (ii) Complete information about practically all donor-funded projects is included in fiscal reports. (A)</p>	D+
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(i) **The level of extra-budgetary expenditure (other than donor funded projects) which is unreported (Score = D)**

43. **The level of unreported government operations is very significant.** For 2006, estimates of the value of oil production used to subsidise the supply of electricity supply and locally refined oil products was around 30%, well over the 10% threshold for a score of “D” (see Tables 9 and 10). This is a priority area for fiscal reporting reform, as relatively simple measures will significantly increase the levels of comprehensiveness and transparency.

Table 9: Estimates of Barter Transactions and Off-Budget Subsidies (ID bn)

Item	Year		
	2006	2005	2004
Oil related barter transactions - external	263	268	517
Oil resources used for electricity generation and fuel subsidies	10,142	6,779	5,022

Source: IAMB audits, MoF and IMF publications

44. **Estimates of the valuation of retained revenues by local and provincial councils are unavailable.** It has been estimated that some governors' offices collect less than 5% of their operating revenues from retained stamp and rental fees¹. However, collection and remittance of local and federal taxes and other service fees and charges is unclear. While the Government has a strong system of control for the opening of bank accounts, it is understood that there may be unmonitored Government bank accounts at lower levels of government. A move to a true Treasury Single Account (TSA) would greatly assist the GoI in monitoring bank balances and ensure only duly authorised accounts are opened and maintained. Further research will be needed to investigate anecdotal reports of collection of unreported and non-remittance of government revenues

Table 10: Scoring for First Dimension (PI 7)

	Year	Unreported Govt Ops	Total Exp (ID b)	% Total Exp.	Score
As at end	2006	10,405	34,590	30.1	D
As at end	2005	7,047	26,453	26.6	D
As at end	2004	5,539	28,821	19.3	D

(ii) **Income/expenditure information on donor-funded projects which is included in fiscal reports (Score = A)**

45. **Donor funded project expenditure is significant and income/expenditure information is publicly available.** For dimension (ii), a score of “A” was given as the level of donor financing represents around 22% of total government expenditure in 2006 (25.6% in 2005 and 57.7% in 2004). The level of financial information related to

¹ See World Bank, 2007, “Subnational Public Financial Management: A Diagnostic Report”

donor financed projects included in GoI fiscal reports is sufficient, although it is not provided in a complete and timely fashion. The latest fiscal report on donor projects produced by the GoI was tabled at the recent IRFFI conference in Bari, Italy in October 2007. Fiscal reports are available to the general public on-line using the MoP Development partner Assistance Database (DAD), though the completeness of the data is questionable².

Table 11: Scoring for Second Dimension (PI 7)

Donor financing information in report	Year		
	2006	2007	2008
Grant	6,766	5,673	41,662
Financed	5	3	6
Sub-Total	7,66	6,79	16,62
Total reported donor financing*	7,66	6,79	16,62
Total Gov. Spending (not in kind)	3,66	9,79	46,62
Total Gov. Expenditure	5	3	6
% Donor/Loan projects	0.0	3.09	10.0
Score	A%	A%	A%
Is donor funding significant?	22%	25%	58%

* DAD reports all assistance as grant projects. Most of these would normally be classified as in-kind due to the absence of standard grant agreements.

² DAD access is available at: <http://www.mop-iraq.org/dad>.

PI 8: Transparency of inter-governmental fiscal relations

PI 8	Scoring method M2: (i) Use of transparent and rule-based systems in the horizontal allocation among Sub-National Governments (SNGs) of transfers from national government (A) (ii) Timeliness of reliable information to SNGs on their allocations from central government (D) (iii) Extent to which consolidated fiscal data is collected and reported for general government according to sectoral categories (D)	C
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(i) Use of transparent and rule-based systems in the horizontal allocation among Sub-National Governments (SNGs) of transfers from national government

46. **The GoI now employs transparent and rules based systems in the horizontal allocation among SNGs** of unconditional and conditional transfers from central government (both budgeted and actual allocations). The system for transfers to the KRG is a population based rule after accounting for national public goods. While the system is unsustainable if applied to all regions and provinces, the transparency of inter-governmental fiscal relations has improved significantly. Horizontal allocation of certain resources to the provinces also utilizes a population based weighting method. While transparency of in-kind transfer allocations is a key issue, it is excluded from analysis for scoring purposes of the first and third dimension. Consequently, a score of “A” is applicable (see Table 12)

47. **The status of the conditionality of sub-national transfers is unclear.** While it is understood that transfers to the KRG are essentially unconditional, transfers to the Governorates seem to display characteristics of both conditional and unconditional transfers. Transfers to the KRG only require reporting of expenditure to allow MoF to consolidate reports and to facilitate the estimation of Iraq’ System of National Accounts by COSIT. While the appropriation structure for transfer to Governorates imply conditionality requirements similar to ministries, the recently introduced practice of allowing governorates to retain unspent funds, suggests that the transfers are essentially an unconditional grant to a general/sub national government unit.

Table12: Scoring for First Dimension (PI 8)

SN Governments	Rules-Based	2006	
		Budget	Est. Actual
KRG (Original budget)	Yes	4,275	3,749
Provincial Allocations (original budget)	Yes	84	-
Ninawa	Yes	303	303
Anbar	Yes	146	146
Babil	Yes	167	167
Baghdad	Yes	754	754
Qadisiyah	Yes	111	111
Maysan	Yes	99	99
Basrah	Yes	258	258
Tameen	Yes	122	122
Sad	Yes	123	125
Wasit	Yes	109	111
Kurdish Provinces	Yes	189	196
Muthana	Yes	64	69
Najaf	Yes	109	118
Karbala	Yes	84	93
Dhi-Qar	Yes	195	248
Diyala	Yes	91	149
In-kind allocations (excluded)	No		
Total value of horixontal budget tansfers		7,282	6,818
Horizontal budget transfers supported		7,282	6,818
% of rules based transfers		100%	100%
	Score	A	A

(i) Timeliness of reliable information to SNGs on their allocations from central government for the coming year (Score = A)

48. **Information to the SNGs on allocations for the coming year is relatively reliable and timely.** For the 2007 budget process, dialogue with the KRG and provinces occurred, although final allocations were not agreed until after the start of the fiscal year (and the same situation has obtained in 2008, with considerable political debate over the 17% allocation to the KRG). Hence a score of D is given. While a more transparent system is in place, an improvement in the sequencing and scope of stakeholder consultation is warranted

Table 13: Scoring for Second Dimension (PI 8)

Time when SNGs provided with information	Status
Before the start of the detailed budgeting process.	No
Ahead of completion of SN Budget	No
Before the start of the SN Fiscal Year	No
After SN budgets have been finalized (2007 budget)	Yes
Score	D

- (ii) **Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories (Score = D)**

49. **While consolidated sub-national fiscal data is collected, it is not yet reported according to sectoral categories.** A score of D was given for the third dimension since the Government is yet to publish consolidated sub-national fiscal data according to sectoral categories in annual reports (see Table 14). In 2006, fiscal data was collected using the legacy accounting system, which does not yet include functional or sectoral information.

Table 14: Scoring for Third Dimension (PI 8)

2006	Central Government Reporting		Consolidated Reporting		AR - Months after end FY	Type of Budget Class'n system	Type of Actuals Class'n system	Budget Clas'n Consistency	Actuals Clas'n Consistency
	Budget (ID b)	Est Act (ID b)	Budget (ID b)	Est Act (ID b)					
KRG (Original budget)	4,275	5,298	4,275	5,298	19	Other	Other	No	No
Provincial Allocations (original budget)	84	84	84	-	19	Other	Other	No	No
Ninawa	303	303	303	303	19	Other	Other	No	No
Anbar	146	146	146	146	19	Other	Other	No	No
Babil	167	167	167	167	19	Other	Other	No	No
Baghdad	754	754	754	754	19	Other	Other	No	No
Qadisiyah	111	111	111	111	19	Other	Other	No	No
Maysan	99	99	99	99	19	Other	Other	No	No
Basrah	258	258	258	258	19	Other	Other	No	No
Tameen	122	122	122	122	19	Other	Other	No	No
Sad	125	123	125	123	19	Other	Other	No	No
Wasit	111	109	111	109	19	Other	Other	No	No
Kurdish Provinces	196	189	196	189	19	Other	Other	No	No
Muthana	69	64	69	64	19	Other	Other	No	No
Najaf	118	109	118	109	19	Other	Other	No	No
Karbala	93	84	93	84	19	Other	Other	No	No
Dhi-Qar	248	195	248	195	19	Other	Other	No	No
Diyala	149	91	149	91	19	Other	Other	No	No
Total	7,429	8,305	-	-	19				
% Reported			0%	0%				Score	D

PI 9: Oversight of aggregate fiscal risk from other public sector entities

PI 9	<p>Scoring method M1:</p> <p>(i) Extent of central government monitoring of Autonomous Government Agencies and Public Enterprises (D)</p> <p>(ii) Extent of central government monitoring of SNG's fiscal position (D)</p>	D
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50. **Under Section 8 of the FML on Public Corporations, AGAs and PEs are required to submit fiscal information.** The following are the three key reports required by these entities:

- Monthly accounts submitted to the competent ministry 10 days following the end of each month.
- Semi-annual accounts submitted to the Minister of Finance no later than July 15th.
- Audited final accounts submitted to the Minister of Finance no later than March 31st of the year following the fiscal year ended.

51. **In practice, there is an absence of fiscal and audit reports for AGAs and PEs,** nor is there a central consolidation of these entities’ fiscal risks. Similarly, there appears to be no effective monitoring of the fiscal position and associated fiscal risks of AGAs and PEs. It is also understood that sub-national governments can generate fiscal liabilities for the Government of Iraq. Accordingly, a score of “D” is applicable for both dimensions.

PI 10: Public access to key fiscal information

PI 10	Scoring method M1: Number of the elements of complete information listed below to which the public have access (0 out of 6)	D
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52. **This Indicator assesses whether information on fiscal plans, positions and performance of the government is easily accessible to the general public, or at least to the relevant interest group.** Six elements of information to which public access is essential are considered.

53. **In Iraq, while the Government does provide public access to certain fiscal information, the public does not have complete or timely access to key fiscal information.** The 2006 annual budget papers were not available to the public at the time of transmittal to the Council of Representatives (CoR), either through a citizen’s guide to the budget or on a central web-site. The MoF does, however, provide access to budget documentation on request. While on-line access to the Development Assistance Database (DAD) is available it is understood that most Iraqis do not have access to the internet nor are they aware of the DAD facility. In year, year-end and audit reports have not been available to the public since 2003. Awards of significant contracts and information on the level of resources to primary service units are not published in one easily accessible website or published in local newspapers. Table 15 provides an overview of the key areas where information is occurring and demonstrates how the score of D was obtained.

Table 15: Scoring for PI-10

Budget Documentation	Include	Comment
1. Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature	Partial	2007 Budget Not Available on website at time of transmittal. No hard copies distributed. Budget papers are available on request from MoF and CoR.
2. In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.	No	In-Year Reports Not routinely available
3. Year-end financial statements: The statements made available to the public through appropriate means within six months of completed audit.	No	Year-end financial statements for 2004, 2005 or 2006 Not Available - as at Nov 2007
4. External audit reports: All reports on central government consolidated operations are made available to the public through appropriate means within six months of completed audit.	No	2004 Audits Not Available - as at Nov 2007
5. Contract awards: Award of all contracts with above approx. USD 100,000 equiv. are published at least quarterly through appropriate means.	Partial	Contract Awards not available easily. Some websites.
6. Resources available to primary service information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health).	Partial	Education service information is available on request. Some information published.
Score	D	

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Policy-based budgeting

PI 11: Orderliness and participation in the annual budget process

PI 11	Scoring method M2: (i) Existence of and adherence to a fixed budget calendar (B) (ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (D) (iii) Timely budget approval by the legislature (C)	C
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(i) Existence of and adherence to a fixed budget calendar

54. **A fixed budget calendar exists but adherence to it is mixed.** The Financial Management Law provides the key dates for the annual budget process, which provides sufficient time, just over six weeks, for ministries, departments and agencies (MDAs) to prepare detailed budget proposals. Delays occur in key elements of the budget calendar. A score of “B” is given for the first dimension (see Table 16) because MDAs are allowed more than 4 weeks to submit their detailed estimates

Table 16: Scoring for first dimension of PI11

Financial Management Law (CPA # 95)	FML Deadline	BCC	2007 - Est Act.	Delay (days)	Comments
Finance Minister reports to CoM: Fiscal priorities for coming year Aggregate and Ministry spending limits Final accounts for previous year Progress against current year's budget	31 May		30 Jun	30	Month only specified in Law General priorities Absent Absent Absent
Finance Minister issues budget circular: Guidelines and objectives of fiscal policy Key economic parameters (from macroeconomic framework) Spending limits Spending units use budget circular as the basis for preparing their budget request	15 Jun		30 Jul	45	Month only specified in Law General guidelines Absent Absent - ceilings discussed administratively with MoF, MoPDC and line agencies Limited
Ministries send budget submission, based on budget circular, to Finance and Planning Submission includes: Recurrent and capital outlays for budget year and following two years Revenue from core activities Personnel requirements, multi-year commitments, foreign currency transactions	31 Jul	15-Aug	30 Sep	61	Month only specified in Law No forward estimates Included Staffing profiles included, multiyear commitments and foreign currency transactions absent Frequent revisions to proposed spending limits
Finance and Planning and Development Coordination Ministers hold talks with line Ministers to agree estimates If no agreement, matter referred to CoM	31 Aug	05-Sep	15 Sep	15	Month only specified in Law CoM initiated changes to proposals
Finance Minister sends draft to CoM Finance Minister submits draft Budget, as endorsed by CoM, to the Legislature.	30 Sep 10 Oct		01 Nov 14 Nov	32 35	CoM initiated changes to proposals
Budget Passed by the Legislature.	31 Dec		12 Jan	12	
Time for MDA Preparation: Law	6.6	Weeks	8.9	4.7	Average Delay (weeks)
Budget Preparation Manual	No	Budget Calander	Delays	Reasonable Time for MDAs	
		Unclear	Yes	Yes	Budget Circular inconsistent with FML
		Score	C		

(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions

55. **Content of the Budget Call Circular (BCC) and budget guidance is deficient, although sufficient time is provided to MDAs to prepare budget submissions.** For the 2007 budget process, MDAs were provided with around two months for budget submission preparation. The BCC provides general policy direction instructions and the deadline for the submission of budget proposals to the MoF. The BCC also provides the time period (just over two months) for negotiations between the MoF and MoP and line ministries and staffing profile table and budget proposal templates.

56. **The BCC is issued late and does not provide sectoral or administrative expenditure limits.** An investment budget circular is also prepared by the MoP, which provides additional guidance on information requirements for investment projects. The MoP collates and approves project requests at official level and forwards results to the MoF for consolidation. A detailed budget manual has not been issued. Consequently, a score of “D” is given for the second dimension (see Table 17).

Table 17: Scoring for Second Dimension (PI-11)

Budget Circular		
Clarity	Comprehensiveness	CoM Approval of ceilings
Unclear	Limited	Limited/Late
Score	C	

(iii) Timely budget approval by the legislature (C)

57. **Approval of the budget by the legislature did not occur before the commencement if the fiscal year in the last 3 years.** Consequently, the score for the third dimension is “D” (see Table 18). The 2008 Budget is likely to be passed by the legislature before or soon after the start of the 2008 fiscal year since the Budget Bill was approved by the CoM on 13 November and subsequently transmitted to the CoR, with the first reading completed on 19 November and second readings on 27 November and 5 December. This represents a 65% improvement in the timeliness of transmittal to the CoR compared to the 2007 Budget process.

Table 18: Scoring for Third Dimension (PI-11)

Budget Year	Budget Approval Date by CoR	Months after start of FY
FY07	08-Feb-07	1.3
FY06	28-Jan-06	0.9
FY05	12-Jan-05	0.4
FY04	01-Nov-03	-2.0
Score	C	

PI 12: Multi-year perspective in fiscal planning, expenditure policy and budgeting

PI 12	<p>Scoring method M2:</p> <ul style="list-style-type: none"> (i) Preparation of multi-year fiscal forecasts and functional allocations (C) (ii) Scope and frequency of debt sustainability analysis (B) (iii) Existence of sector strategies and multi-year costing of recurrent and investment expenditure (D) (iv) Linkages between investment budgets and forward expenditure estimates (D) 	D+
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(i) Preparation of multi-year fiscal forecasts and functional allocations

58. **Forecasts of fiscal aggregates are prepared on the basis of main economic categories for four years.** Forecasts by function of government of sector are not yet constructed systematically. The first multi-year forecast based on economic classifications that was consistent with the Budget is documented in the International Compact with Iraq. The Government envisages that the medium-term forecasts will continue to be published within the ICI annual update reports and eventually in the Budget papers. Linkages between multi-year estimates and subsequent setting of annual budget ceilings are not yet occurring. Consequently, a score of “C” is considered appropriate (see Table 19).

Table 19: Scoring for First Dimension (PI-12)

Forecasts of fiscal aggregates			
Economic classification	Functional/sector classification	No of FE Years	Links between multi-year estimates and budget ceilings
Yes	No	>=3	No
Score		C	

(ii) Scope and frequency of debt sustainability analysis

59. **On request by the GoI, Debt Sustainability Analysis (DSA) was undertaken in May 2004 by the IMF.** This analysis was primarily for external debt, however, domestic debt was also considered. It is understood that the GoI has undertaken some analysis of domestic debt³ in respect to large and small private creditors. The World Bank assisted the GoI in May 2007 with a fiscal sustainability assessment, which incorporated a review of external debt sustainability. DSA updates also occur regularly as part of the Government’s program with the IMF. Consequently, score of B was considered appropriate for this indicator (see Table 20)

Table 20: Scoring for Second Dimension

DSA			
External	Domestic	No Years EDSA Undertaken	No Years DDSA Undertaken
Yes	Yes	3	1
Score		B	

(iii) Existence of sector strategies and multi-year costing of recurrent and investment expenditure

60. **Sector strategies that are established within a multi-year costing of recurrent and investment expenditure framework are absent.** Some strategic plans exist for a number of ministries (e.g. Ministry of Agriculture, Ministry of Education, Higher Judicial Council, the Juvenile Reform Department within the Ministry of Labour and Social Affairs, Ministry of Defence and the Ministry of Justice). The Rule of Law working group is progressing development of a sector strategy. Through this joint PEIA, the MoF and MoP are also in the process of developing a medium-term PFM reform program that will be costed in terms of operating and investment expenditure, with resources allocated from various sources including the Government’s Budget, multilateral agencies and bilateral arrangements. The GoI also established a general policy foundation to develop sector strategies, within the context of the NDS and the ICI. Systems are being developed by the MoP that are expected to support multi-year costing of recurrent and investment expenditure.

³ Domestic debt is debt owed to creditors resident in the same country as the debtor, and denominated in local currency.

Table 21: Scoring for Third Dimension (PI-12)

Sector	Strategy Tupe	Costing Type	Consistency with fiscal foecast	Costing Value	Fiscal Forecast (Budget 05 only)	Est. Act
General Public Services	Strategy/Prog	None	No		11,821	9,961
Defence	Strategy/Prog	Partial	No		1,844	1,438
Public Order and Safety	Strategy/Prog	Partial	No		1,292	1,224
Economic Affairs	Strategy/Prog	Partial	No		10,643	8,345
Environmental Protection	None	None	No		101	132
Housing and Community Development	Strategy/Prog	Partial	No		715	667
Health	None	Partial	No		1,417	1,130
Recreation, Culture, Religion	None	Partial	No		100	100
Education	Strategy/Prog	Partial	No		1,493	1,236
Total			0%	-	29,426	24,233
Score	D					

61. **Reform of the Government budget preparation process and integration of key elements of the Budget will be needed** to ensure that strategies that do get developed are properly costing and considered within the annual budget process. For scoring purposes, a “D” is considered appropriate as only a few sector strategies have been prepared and none of them have substantially complete costing of investments and recurrent expenditure (see Table 21).

(iv) Linkages between investment budgets and forward expenditure estimates

Table 22: Scoring for Fourth Dimension (PI-12)

Investments				
Sector Strategy	Selected on basis of Sector Strategy	Recurrent Cost	Sector Allocations	FE inclusion
General Public Services	Partial	No	No	No
Defence	Partial	Partial	No	No
Public Order and Safety	Partial	Partial	No	No
Economic Affairs	Partial	Partial	No	No
Environmental Protection	Partial	No	No	No
Housing and Community Development	Partial	Partial	No	No
Health	Partial	Partial	No	No
Recreation, Culture, Religion	No	No	No	No
Education	No	Yes	No	No
Social Protection	No	Yes	No	No
Is the Budgeting for investment and recurrent expenditures separate processes with no recurrent cost estimates being shared?				Yes
Score	D			

62. **Linkages between investment budgets and forward expenditure estimates are not yet observable.** While, some projects are selected based on sector plans, and some of these have recurrent cost implications estimated, these estimates are not shared during operations budgeting. Moreover, the forward estimates that do exist are not developed from such costings. Consequently, a score of “D” is appropriate for the fourth dimension (see Table 22).

Predictability and control in budget execution

PI 13: Transparency of taxpayer obligations and liabilities

PI 13	Scoring method M2: (i) Clarity and comprehensiveness of tax liabilities (B) (ii) Taxpayers’ access to information on tax liabilities and administrative procedures (B) (iii) Existence and functioning of a tax appeals mechanism (B)	B
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(i) Clarity and comprehensiveness of tax liabilities

63. **Transparency of taxpayer obligations and liabilities concerns the environment in which taxation revenue administration functions.** Revenue sources from most countries are from taxation activities. However, countries like Iraq present a different situation where revenue resources are mostly derived from non-tax activities (e.g. for selling petroleum and petroleum products). Therefore, it is essential that there should also be transparency surrounding the environment in which non-tax revenue is collected and reported.

64. **The GoI’s tax revenue base represents around 5% of general revenue or approximately 2% of GDP.** The Government is working towards increasing the tax base by improving the effectiveness of the tax and customs administrations.

65. **The General Commission for Taxation (GCT) and the General Commission for Customs (GCC) are responsible for revenue administration** in Iraq. The Ministry of Oil, through the State Organisation for Oil Products and Gas Distribution (SOOPGD), is responsible for administering the hypothecated excise tax on sales of domestic fuels.

66. **The legal framework for taxation is established around five major taxes,** which represent over 90% of all tax revenue. Five additional minor taxes are also in place. Tax on international trade is the most significant source of revenue (30% of tax revenue). Reports indicate that half of all individual income tax (27%) is paid by Government officials. Corporate income tax is less than half of personal income tax collections. The existing consumption tax raises around 15% of all tax revenue but is limited to levies on services provided by deluxe and first class hotels and restaurants. A fuel excise tax on petrol, diesels and LPG is estimated to raise a further 10% of all taxation revenues. The tax is hypothecated to finance the State-owned fuel distribution network and is in essence a user charge.

67. **Tax legislation is clear and comprehensive for three of the five major taxes.** While exemptions and deduction provisions exist, they are clearly specified in legislation and discretionary powers are either strict or limited. However, the lack of procedural documentation that guides officials during assessments exposes the system to an appearance of unfairness. Consequently a score of B is given for the first dimension (see Table 23).

Table 23: PEFA Scoring for First Dimension (PI-13)

Taxes	Legislation	Administering agency	Legislation Comprehensive and Clear	Procedures	Discretionary Powers	Significance of Tax (% est. of 2007 tax forecast)	
Major Taxes							
Customs Tax	Custom Law No (23) of 1984, Custom tariff law No (77) of 1955, CPA Order Number 54 - Trade Liberalization Policy 2004, CPA Order Number 38 - Reconstruction Levy, CPA Order Number 70 - Amendments To Reconstruction Levy, CPA Order Number 12 Recinded	General Commission for Customs	Yes	Yes	Limited	94% 30%	
Direct Tax (Individual and wage withholding)	Income Tax Law No. 113 of 1982 (Corporate income tax, Wage Withholding tax, Contracts Withholding Tax, Individual Income Tax), Instructions No.(1) of 2005 Concerning Income Tax Deduction by Direct Deduction Method, The System of Depreciation and Elimination for Private, Mixed and Cooperative Sectors Regulation No. 9 of 1994, CPA Orders No. 37 and 49 of 2004	General Commission for Taxes / Ministry of Finance (<i>civil service employee income tax</i>)	Yes	No	Strict	27%	
Sales Tax	Hotel Tax (Resolution No. 36) Republic of Iraq Revolutionary Command Council 5/4/1997 , Resolution No. 36 of May 4th 1997 and Fiscal Instructions No. 7 of 1997, Car sale fee in accordance with Resolution Number 80 of 1998, CPA Orders No. 37 and 49 of 2004	General Commission for Taxes	Yes	Yes	Limited	16%	
Direct Tax (Corporate and contract withholding)	As per direct tax above	General Commission for Taxes	Yes	Yes	Strict	12%	
Fuel Excise Tax	Law Number 9 of 1939, Revolutionary Command Council Resolution No. 82 of 1996 and the Order No. 66 of 1999 issued by the Economic Affairs Committee, CPA Orders No. 37 and 49 of 2004	Ministry of Oil, SOOPG	No	No	Substantial	8%	
Minor Taxes							
Real Estate Rental Tax	Law of the Real Estate Tax (No. 162) for the year 1959 and its amendments including CPA Orders No. 37 and 49 of 2004	General Commission for Taxes	Yes	No	Strict	6%	
Real Estate Transfer Tax	Real Estate Tax Law No. 162 of 1959, Resolution No. 120 of 2002, CPA Orders No. 37 and 49 of 2004	General Commission for Taxes	Yes	No	Limited		
Vacant Land Tax	The Vacant Land Tax Law No. 26 of 1962	General Commission for Taxes	No	No	Limited		
Inheritance Tax	Inheritance Tax Law No. 64 of 1985 (repealed by law No. 22 of 1994 and still valid for cases that occurred during its validation period).	General Commission for Taxes	No	No	Limited		
Agricultural Land Tax	Agricultural Land Tax (Law No. 60 of 1961)	General Commission for Taxes	No	No	Limited		
							Score
							B

(ii) Taxpayer access to information on tax liabilities and administrative procedures

68. Income and import tax payers have generally easy access to comprehensive, user friendly and up-to-date information on major taxes and administrative procedures. Bilingual websites are available and provide easy access to income and customs legislation and user friendly guidance. Half the income tax payers are civil servants, which helps with access to those without internet access. Withholding tax arrangements allow easy compliance. The GCC and GCT are both well represented throughout Iraq with offices at the Governorate level. The sales tax levied on services provided by deluxe and first class hotels and restaurants is very clear, since it is a flat 10% tax on specific hotels and restaurants. The sales tax collection process is clear and simple to administer. The excise tax on fuels is also easy to comply with, as the tax is included in the official prices for petrol, diesel and LPG. Minor taxes, such as the real estate, rental and transfer taxes, inheritance tax and agricultural land tax are not included in this assessment, however, they are understood to be more complex to administer. Consequently, a score of “B” is given.

Table 24: PEFA Scoring for Second Dimension (PI-13)

Taxes	Easy access	Comprehensive	Up-to-date information	User friendly/ education campaigns
Customs Tax	Yes	Yes	Yes	Yes
Direct Tax (Individual and wage withholding)	Yes	Yes	Yes	Yes
Direct Tax (Corporate and contract withholding)	Yes	Yes	Yes	Yes
Sales Tax	Yes	Yes	Yes	Yes
Excise Tax (including petrol)	Yes	Yes	Yes	Yes
Other taxes				
Real Estate Rental Tax	Yes	No	No	Yes
Real Estate Transfer Tax	Yes	No	No	Yes
Vacant Land Tax	Yes	No	No	Yes
Inheritance Tax	No	No	No	No
Agricultural Land Tax	No	No	No	No
Score	B			

(iii) Existence and functioning of a tax appeals mechanism

69. **The Income Tax Law No. 113 of 1982 outlines the appellate process and establishes the Appeal Committee and Cassation Panel.** Appeal Committee members are appointed by the Minister for Finance. The Cassation Panel is headed by a judge from the Court of Cassation and two members who are director generals from the MoF and one member from each of the Iraqi Commercial Chambers Union and the Iraqi Industries Union.

70. **A straightforward appeals process is clearly documented in the legislation and involves three levels.** The first level is that an appellant can object to an assessment in writing to the GCT, which the GCT can accept if it so determines. If the GCT rejects the objection, the appellant can appeal the decision through the Appeals Committee. The third level is invoked if the Appeals Committee rejects the objection and the appellant brings forward the objection to the Cassation Panel. A detailed assessment of effectiveness of operation and fairness could not be determined without an in-depth review of documentation. However, it is understood that the appeals process is functioning and there have been no well publicised cases of appeals being sought or rejected (even with the MoF’s increased efforts to contain levels tax evasion). An arbitration system is not in place for taxation matters. However, this procedure is outside the scope of this indicator. Nevertheless, establishment of formal procedures for resolution of disputes outside the courts is a useful judicial policy approach that saves time and money. A similar appeals process is understood to be operation in the GCC. A score of “B” is appropriate (see Table 23).

Table 23 : PEFA Scoring for Third Dimension (PI-13)

Tax Appeals System	Established	Transparent administrative procedures	Appropriate checks and balances	Independent institutions	Appropriate checks and balances	Effectively operating	Satisfactory Fairness
Appeal Committee and Cassation Panel - Income Tax Law	Yes	Yes	Yes	Yes	Yes	Partial	Partial
Score	B						

PI 14: Effectiveness of measures for taxpayer registration and tax assessment

PI 14	Scoring method M2: (i) Controls in the taxpayer registration system (C↑) (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations (B) (iii) Planning and monitoring of tax audit and fraud investigation programmes (D)	C
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(i) Controls in the taxpayer registration system

71. Individual and company taxpayers are registered in the GCT's computerized database system. The Government's process for registration requires basic linkages. All companies are required to register with the Business Registry (BR) of the Ministry of Trade (MoT). The BR Number is not mandatory but facilitates sharing of information between the GCT and MoT. Linkages to other registration and licensing functions are weak. Every tax payer in the database, both individual and corporate, has been issued with a Taxpayer Identification Number (TIN). As at August 2007, an additional 1,696 companies have been added to the database with the total of around 22,000 companies registered. Also in 2007, 9,350 new individual income tax payers have been registered and issued with a TIN.

72. New software and computerization for the GCT is being progressively rolled out. The MoF has allocated ID0.5 billion (US\$0.4 m) to purchase new computers as part of its tax administration reform program. The program involves establishing a comprehensive tax communication network throughout Iraq to facilitate more timely and comprehensive tax collection and information services. Currently the score is "C", however, as the wider Tax network becomes operational it is expected that the score should rise to "B".

(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations

73. Enforcement powers and sanctions for non-compliance with tax related legislation are in place and are sufficient to provide key incentives for compliance with tax rules. Actual compliance, however, should be improved with more consistent administration and better systems. The low levels of compliance, as reflected by the low tax effort, are believed to be due to passive rather than active non-compliance. The security situation since 2003 has not provided the environment to enable easy compliance or active collection.

74. Consistency and more activity in taxation administration are appearing. That the public administration is becoming more active in the taxation area is evidenced by:
i) the MoF's increased efforts to contain levels tax evasion and success in increasing

levels of tax collections; ii) the significant increase in the number of company and individual Taxpayer Identification Numbers issued; and iii) increased financial commitments to tax administration reform as highlighted by the MoF’s allocation of resources for computers and software. The score for this dimension is “B”.

(iii) Planning and monitoring of tax audit programmes

75. **Tax audits and fraud investigations are undertaken on an ad hoc basis (Score =D).** Self assessed tax liabilities and payments are audited by the GCT and GCC using an ad-hoc but risk-based like auditing approach. Audit selection is confined to identifying unregistered taxpayers, with some targeting, and those taxable activities that involve significant revenue generating potential. The Government intends to continue its efforts to reduce tax evasion and increase voluntary compliance. Improving information systems will enhance audit planning and improve effectiveness. The Government is considering other reform options to improve monitoring, auditing, and enforcement.

PI 15: Effectiveness in collection of tax payments

PI 15	Scoring method M1: (i) Collection ratio for gross tax arrears (Not rated) (ii) Effectiveness of transfer of tax collections to the Treasury (B) (iii) Frequency of complete accounts reconciliation of tax assessments, collections, arrears and transfers to the Treasury (D)	D+
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(i) Success in collecting tax arrears (proportion of the amount outstanding at the beginning of the year actually collected during the year)

76. **In Iraq, the importance of taxation for revenue generation is currently much less than in other countries.** Nevertheless, appropriate⁴ broadening of the revenue base by increasing the tax effort is important for the Government to reduce the impact of oil price fluctuations on fiscal policy⁵. In this regard, the Government has commenced development of a medium-term tax reform strategy with technical assistance provided by development partners, including the IMF. In particular, reforms being considered are the introduction of a flat rate consumption tax and administration strengthening.

77. **Estimates of levels of tax arrears are not yet available.** Tax arrears are the amounts overdue by tax payers, once the assessment has been finalized and payment timeframes have lapsed. Part of tax arrears may represent disputes between tax payers and revenue administration authorities. The GCC, GCT and the Accounts Department within the MoF report actual tax collections to the Minister for Finance on a monthly basis. Currently, the value of tax assessments and arrears are not included in that report.

78. **To promote timely estimation of tax arrears, systems are being established and reform measures are currently being considered** by the MoF, GCT and GCC. Tax administration is improving with a 16% increase in collections as compared to last year (as at August 2007). This increase is more likely to be due to the increase in the number of taxpayers than a reduction in tax arrears, given the current Government

⁴ It has been argued that countries affected or coming out of conflict should attempt to maintain a low tax base if possible.

⁵ Stabilization funds are a key measure to mitigate the effects of fluctuations in the world price of oil prices on fiscal policy.

priorities in the area (i.e. to increase taxpayer registration and target tax evaders). The MoF has also identified that political, administrative and security instability have been the major constraints in progressing taxation reform in recent years. Moreover, the MoF indicated that improved stability in the political environment and administration is cause for increased optimism for better outcomes from reform and operational efforts.

79. **It is likely that the the total amount of tax arrears is significant and the debt collection ratio⁶ in the last fiscal year was below the 60% threshold** for a score of D. Information is not yet available to estimate the debt collection ratio as systems are not sufficiently established so the dimension is not rated. It is possible that data may indicate far better performance given that tax arrears are based on an actual assessments lodged with the revenue authority and an actual payment made by the taxable person.

(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administrations

80. **In 2006, the system for transfer of tax collected by the GCT to the MoF was that all tax payments had to be made in Baghdad and all payments were to be deposited in the Commissions' sub-account of the MoF.** Consequently, the score for the GCT in 2006 is an A. For 2007, however, this score is likely to fall significantly as the Government is keen to increase the level of compliance by making it easier for tax payers to make assessed payments in the area where they live. This measure is therefore likely lead to a situation where revenue collection reports and cash transfers to the MoF will occur monthly or less regularly. Under legislation, however, each employer is required to deduct the due tax from employee salaries and pay it to the GCT within 15 days of the next month.

81. **Under the Section 4.9 of the FML, all receipts must be credited to the Treasury Consolidated Account and paid into the Treasury Single Account.** Under Section 9.7, government agencies are required to submit reports on realized receipts (and executed payments) to the Minister for Finance within 30 days following the end of each month. Revenue transfers to the treasury at the governorate level are through actual cash deposit to the MoF's governorate treasuries. Trial balance reports indicate that transfers do occur on regular basis in accordance the FML. For payments of taxes on Government salaries, this is handled within the MoF accounting procedures, and so is essentially an automatic process. Consequently, the likely score for 2007 is likely to be a "C".

82. **For the GCC, border transactions follow a similar process.** Timeliness depends on location. Consequently, a score of "B" is given for the GCC in 2006. Overall therefore, a score of B is given for 2006.

(iii) Frequency of complete reconciliations of tax assessments, collections, arrears records and Treasury receipts

83. **Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place** annually or is done with more than 3 months' delay. There is no comprehensive system in place to reconcile tax assessments, collections, arrears records and receipts. The system used by the Accounts Department of the MoF, GCC and GCT, is the trial balance reporting method, designed primarily for liquidity accounting. While this system allows reconciliation of transfers and collections it does not identify arrears or assessments. Systems are developing in agencies that will

⁶ Debt collection ratio = Assessed taxation arrears collected/ total assessed tax arrears in a given time period.

improve reconciliation. Progress on system development will be essential to improve the “D” score for this dimension.

PI 16: Predictability in the availability of funds for commitment of expenditures

PI 16	Scoring method M1: (i) Extent to which cash flows are forecast and monitored. (C) (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment. (C) (iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs. (C)	C
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(i) Extent to which cash flow are forecast and monitored

84. **This indicator primarily assesses the extent to which the MoF provides timely and consistent information on ‘availability of funds’ to MDAs.** Timely and consistent information allows MDAs confidently to commit resources⁷ without risk of default, inadvertently compromising the government’s cash position and/or breaching appropriation limits. The quality of cash flow planning, monitoring and management partly determines the predictability of the availability of funds. The degree of predictability is also determined by how transparent in-year reallocation adjustment processes are, since unanticipated events that impact on actual revenue collections and expenditures often occur. Transparent processes provide incentives to budget well, plan and monitor cash requirements and report timely and accurately.

85. **The indicator focuses on MoF performance, but it also provides important information on the credibility of MDA budgets.** Predictability in the availability of funds is determined by the behaviour of both the MoF and MDAs. Credible MDA budgets facilitates realistic MDA cash requirement forecasting and reporting, which in-turn facilitates central cash flow forecasting and reporting. Credible MDA budgets also mitigate the frequency of in-year requests for adjustments to budget allocations. (See also indicator 20 for Iraq’s system of commitment controls, which is essentially through liquidity management rather than true commitment monitoring.)

(i) Extent to which cash flows are forecast and monitored

86. **The FML and annually issued budget execution instructions outlines the reporting process that are critical for effective cash forecasting and monitoring.** The FML establishes the main system for accounting and reporting as the “Treasury General Ledger” (TGL), which is required to be based on double entry principles. The following are key provisions in the FML and the Instructions for Executing the Federal Budget (2007 IEFB) that refer to cash forecasting.

- FML Section 9.7: MDAs are required to submit reports on realized receipts (and executed payments) to the Minister for Finance within 30 days following the end of each month. It also requires that consolidated monthly budget

⁷ The FML defines a commitment as an undertaking to make an expenditure following the conclusion of a binding agreement that will result in a payment . It goes on to say that a commitment will terminate at the end of the life of the appropriation and unspent appropriations will lapse at the end of the financial year except for what has been ordered and received.

execution reports on receipts and payments reports be published and distributed widely.

- IEFB 2007
 - Section 1.1: Requires that agencies to provide TGL reports to the MoF in “Trial Balance” form⁸.
 - Section 1.2: requires MDAs to provide monthly cash flow forecast reports and specifies the scope of such reports.
 - Section 1.4: MDAs are required to provide monthly unified use of funds reports to the MoF.
 - Section 4.4: Requires the MoF to report to the MoP within 30 days of the end of each month. MoP reconciles these reports with project implementation reports provided by agencies.

87. **The Government essentially employs a top-down and bottom up approach to liquidity management.** The top down stage utilized by the Accounts Department and Cash Management Unit of MoF in Baghdad is essentially a process of monitoring the following three elements:

- Overall cash position as reported by the CBI;
- Actual and forecast cash in-flows obtained from information contained in monthly reports by the MoO, CBI, MoP and MoF departments (e.g. GCC, GCT; Debt Management Unit (DMU) and Budget Department); and
- Actual cash out-flows from cash releases by the MoF to MDA accounts held in the CBI and MoF Governorate accounts.

88. **The bottom up approach introduces two additional elements.** These element rely on the timely provision of annual and monthly reports by MDAs and are as follows: i) actual cash spending as reported by MDAs and MoF treasuries located in the Governorates; and ii) updates to the annual and monthly cash requirement forecasts reported by MDAs.

89. **In practice and as an MoF priority, liquidity is assessed at the beginning of the year and prior to in-year release of cash allocations.** Cash for employee compensation is automatically released on the on the basis of 1/12th of Budget appropriation allocations. Release for other expenditures are based on cash requirements and are not subject to time constraints, i.e. it is possible for an MDA to receive full access to their appropriation at the beginning of the year should a sufficient and compelling case be presented.

90. **The Government’s liquidity position has not been constrained** due to the low levels of budget expenditure execution rates and overshooting of budget revenue forecasts (see Table 24). Consequently, the MoF and MDAs have not been under pressure to focus on improving the quality of cash flow forecasting, even though a strengthened system would facilitate improvements in budget execution and budget preparation.

Table 24: Government Cash Reserves

⁸ Trial balance reporting is the traditional reporting format that reconciles recorded expenditures with bank balance transactions

	2004	2005	2006
DFI Cash Flow Balance	4,923	1,360	2,327
MoF Cash Flow Balance	-	1,008	278
Minsitries Cash Balances	tba	tba	tba
Cash Balance at End of Year	4,923	7,291	9,895
Next FY Budget Balance	-3,714	-7,669	-10852
Cash Reserves for Next FY	1,209	-378	-957

91. **A cash flow forecast was prepared for the 2007 fiscal year and key elements have been updated but the frequency of updates is uncertain.** The updates have been based on actual cash inflows and outflows reported by central agencies and MDAs. Improvements in the comprehensiveness of cash flow forecasting updates is constrained by the provision of timely and complete information from MDAs. The bottom-up cash flow forecasting approach is not yet delivering the needed information. Trial balance reconciliations are also taking longer due to the implementation of the new GFS based classification system and discrepancies between reconciliations between project implementation reports provided to the MoP and TGL reports provided to the MoF by MDAs. Consequently a “C” is given for this dimension.

(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment

92. **In the case of the 2007 Budget, the Government decided that, in order to improve budget execution performance, it would moderate internal controls and liquidity management practices.** One measure was the relaxation of allocation release processes. There are two forms of allocation releases and three different allocation releases procedures. Allocations can either be in the form of: i) *cash transfer* to an MDA specified bank account held at the CBI or other authorised bank; or ii) an *authority to draw* on MoF accounts managed by central or governorate treasuries. The three types of allocation release processes are as follows:

- **For employee compensation:** Allocation is released automatically every month at the rate of 1/12th of the employee compensation amount as apportioned in the Annual Budget Law. The Budget Department issues the authorisation at the beginning of the year to the CMU in the Accounts Department for action. After confirming liquidity levels (and unallocated appropriations during the year) the Accounting Department issues the allocation authority⁹. Changes to the 1/12th procedure are also approved by the Budget Department in consultation with the Accounts Department. The Budget Department checks the Budget establishment control list if appropriate.
- **For other operational budget allocations:** Releases are based on MDA requests. As a minimum, requests are included in the monthly reporting cycle through the trial balance reports, unified use of funds reports and cash forecast statements. MDAs can request allocations for any period length based on their cash forecasts and compelling justification. The process steps

⁹ Either through an instruction to: i) the CBI to transfer funds from the MoF central account to the sub-account of the MDA; or ii) an MDA treasury or MoF Governorate treasury providing the authorization to draw on MoF treasury sub-accounts.

for the issuance are essentially the same as above except for the time periods and less involvement of the Budget Department.

- **For investment budget allocations**, the process involves MDAs, MoP and MoF. MDAs providing unified performance reports to the MoF, which includes information on use of funds for investment budgets. To secure allocations and meet oversight reporting requirements, MDAs also report to the MoP using prescribed forms on all approved projects in their investment budgets. MoP requires economic and technical feasibility reports of all projects and copies of correspondences related to project execution (e.g. direction to proceed and verification of works provided). Project reports are provided at the beginning of the year after the Budget has been passed and determines the initial cash and allocation requirements. These reports are tend to be quarterly, but can be updated more frequently. In-year investment budget releases are secured when the MoP writes to the MoF informing of their approval of satisfactory project progress. MoP's memorandum also prescribes the amount needed for release in accordance with the agreements with the MDA. After confirming the project is an approved budget, there is sufficient level of unallocated funds in the MDA investment budget, and reconciliation with any unified reports received, the MoF then issues the cash transfer or authority to draw as appropriate. Once actioned, MoF then informs the MoP.

93. **There are opportunities to simplify and streamline the allocation and cash release processes.** The existing process may be compromising the predictability of actual availability of funds to allow timely commitment of expenditures. It is understood that, while significant improvements have been demonstrated on allocation releases and investment budgeting, there remain reporting problems. Moreover, time-lags are occurring as a result of the time needed to resolve disagreements between the MoF, MoP and MDAs.

94. **MDAs are officially allowed to plan and commit expenditure for at least six months in advance** in accordance with the budgeted appropriations. In practice however, it should be noted that a) there is no commitment system in place and b) MDAs plan and commit expenditure at best on a quarterly basis. Current levels of predictability of resource availability appear not to be a result of low quality or untimely information provided by the MoF to MDAs. It seems to be a more systemic issue concerning planning, the lack of commitment controls and reporting. Consequently a "C" is given for this indicator

(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs

95. **Rules for in-year adjustments are clear.** These are contained in the FML and temporary amendments reflected in the 2007 Budget Law and supported by issued instructions. Section 9.8 of the FML provides the scope and limits to in-year adjustments. Essentially, the laws provide detailed and precise the conditions for in-year adjustments:

96. **While minor adjustments to budget allocations are frequent, the adjustment approval process is well administered.** It is understood that over 3,000 minor in-year adjustments took place in 2006. Most of these, however, were multiple reallocations

within MDAs and increases on request of MDAs. These reallocations (by value) were predominately for transfers to employee compensation financed by reduction in the goods and services and non-financial assets of the respective MDA’s operational budget. Two clarifications were required for erroneous presentations in the 2006 Budget table for pensions under the MoF’s General Activities of the State Budget and the Ministry of Construction’s Investment Budget (see Attachment 2). The high frequency and scope of within-MDA adjustments is an indicator that improvements during budget preparation and establishment list control procedures are needed. That said, the results indicate that fiscal discipline is established in terms of in-year adjustment procedural compliance.

97. **Significant decreases (by number) are rare.** Other expenditures for the MoF’s General Activities of the State program, was the by far the most significant decrease at just under ID 300 billion in aggregate, representing 7% of the original allocation. There were only two other significant decreases to line items that occurred: the Other Expenditures budget of the Ministry of Interior and the Assets Maintenance budget for the General Activities of the State program. Each decreased by just over 25 billion in aggregate.

98. **Fourteen (14) MDAs had their allocations increased** in aggregate, which were basically funded by the decrease in the allocation of the MoF’s General Activities of the State program. Only one minor breach of in-year budget reallocations was identified with the Ministry of Culture having their appropriation increased over the allowed limit by ID3.6 billion.

99. **Overall, significant in-year adjustments to budget allocations take place infrequently and are fairly transparent.** Consequently, a score of “C” is appropriate for this indicator

PI 17: Recording and management of cash balances, debt and guarantees

PI 17	Scoring method M2: (i) Quality of debt data recording and reporting. (C) (ii) Extent of consolidation of the government’s cash balances. (C) (iii) Systems for contracting loans and issuance of guarantees. (C)	C
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(i) Quality of debt data recording and reporting

100. **The legal basis for government borrowing is defined in the Constitution and the Financial Management Law and Public Debt Law** of June 2004 (CPA Order No. 95). The constitution provides the exclusive authority to the Government for negotiating, signing and ratifying debt policies. The FML prescribes administrative authorities and duties related to: i) the issuance of public debt and securities, ii) the payment of outstanding debt; iii) fiscal agents and depositories; and iv) matters concerning debt and securities management. The Law provides a special appropriation, which is indefinite and permanent, to the Minister for Finance for the purpose of buying, redeeming, or refunding Government Debt Securities and for paying interest on securities.

101. **In 2005 the MoF established a Debt Management Unit (DMU)** to support the Accounts Department and senior management within the MoF. The DMU is the centralized government authority to contract new external and domestic debt. The issue and redemption of Government debt securities is managed by the CBI acting as the agent for the GoI. The Government has sought and received assistance from the IMF and the World Bank in this area. The GoI provides debt management data as part of its agreement with the IMF on a Stand-By Arrangement program.

102. **Debt management is a core Government priority** due to significant debt issued by former administrations. The Iraqi authorities agreed with the Paris Club on November 21, 2004 to a debt reduction for Iraq, equivalent to 80 percent in net present value (NPV) terms, to be achieved in three stages subject to the approval and completion of standard IMF programs.

103. **The Government has reduced its external debt stock by over 30%** (see Table 25). Irrevocable debt reductions totalling 60%¹⁰ of Paris Club debt was secured in 2004 and 2005 in accordance with the terms of the agreement with the Club. A remaining 20% reduction is contingent on successful completion of the final review of the third year of IMF standard programs (end-December 2008). Iraq has also resolved some of its debt to non-Paris Club creditors and most private creditors' claims. Iraq has signed agreements with non-Paris Club creditors totalling \$3.4 billion and settled more than \$19.7 billion claims submitted by private creditors. Negotiations to resolve debt with non-Paris Club continues. The Government hopes that further negotiations will be facilitated by the Special Purpose Vehicle (SPV), which the Government established in March 2007 and provides single securitization of restructured debt to official creditors.

Table 25: Estimates of External Debt Stock (US\$ Billion)

External Debt Stock	2004 [^]	2007
Paris Club official creditors	42.6	20.7
Non-Paris Club official creditors	67.7	64.3
Private creditors	20.7	4
Multilateral creditors and others	0.9	1.4
Total debt	131.9	90.4

104. **Domestic and foreign debt records are complete, updated and reconciled quarterly.** Data quality is considered fair, but some gaps and reconciliation problems. Management and statistical reports are not sufficiently comprehensive. Consequently, a score of "C" is given (see Table 26)

Table 26: Scoring for First Dimension (PI-17)

Debt Item	Timeliness			Completeness			
	Quality Records	Records Updated	Records Reconciled	Debt Service	Debt Stock	Operations [^]	Statiscal Reports
Foreign Debt	Yes - fair	Yes - fair	Quarterly	Ye	Ye	N	Ye
Domestic Debt	Yes - high	Yes - fair	Monthl	Ye	Ye	N	Ye
Score	C			s	s	o	s

[^] Terms and conditions of issue, conversion, maturity, payment, and interest rate

(ii) Extent of consolidation of the government's cash balances

¹⁰ Valued at around \$25 billion at the time of the Government's agreement with the Paris Club.

105. **The system for the consolidation of cash balances is assessed against timeliness and completeness.** “*Timeliness*” here means cash balances are consolidated daily and “*completeness*” means all cash balances of the Government are consolidated. Cash balance requiring reconciliation include: a) the central cash position of the MoF; b) the cash position of other Government agencies; and c) extra-budgetary sources. A Single Treasury Account (TSA) is critical for timely and complete reconciliation. A TSA can be computerized for improved timeliness and accuracy or linked through manual systems.

106. **The Government does not yet operate a Treasury Single Account (TSA),** even though the FML defines the Government’s TSA as “*a bank account, or a set of linked bank accounts, of the government through which all government receipts and payments are channelled*”. Due to the non-computerization of the banking and payments system much of TSA operations are handled manually. Controls in the opening, maintaining and closing of Government bank accounts are strengthening.

107. **The GoI’s system for reconciliation and consolidation is founded on the “Trial Balance” method of reporting.** Trial balance reporting is the Governments traditional reporting format that reconciles recorded expenditures and receipts with bank balance transactions (see PI-16 for more information). Regular monthly reporting by most MDAs using the trial balance system allows the Government to know its essential cash position on a monthly basis, although it is understood that some difficulties are experienced with reconciliation of Governorate based accounts. Cash positions of accounts held at CBI can be provided on a daily basis. Calculation of most government cash balances take place at least monthly and the system allows for the consolidation of bank balances. Consequently, score of “C” is appropriate.

(iii) Systems for contracting loans and issuance of guarantees.

108. **The Government’s debt management system within the MoF is essentially manual, supported by spreadsheets.** The system within the CBI is computerized. The legal basis for issuing and contracting is defined in the Constitution and the Financial Management Law and Public Debt Law of June 2004 (CPA Order No. 95) (see the first dimension above). The Government has a debt policy that includes no new borrowing from the CBI as part of its program with the IMF. This policy has been complied with since inception. The Government does roll over treasury bills; however, this does not constitute new lending. The Government administers various microcredit and SME investment credit schemes, which are outside the scope of this dimension; as they primarily involve revolving funds. They are mentioned here as they constitute a fiscal risk if fund management is weak.

109. **Iraq became a member of the World Bank’s Multilateral Investment Guarantee Agency (MIGA) on October 21, 2007¹¹.** The Government has also approved the signing of agreements with the Islamic Development Bank’s Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC). It is assumed

¹¹ Iraq will become a full member of MIGA once the ratification process is complete and its initial capital contribution is received by MIGA.

that no guarantee has been issued recently in the Government¹². Most guarantee related issues in Iraq are related to project payments and are handled through letters of credit.

110. **The DMU is the centralized government authority to contract new external and domestic debt.** The Minister for Finance is the Government authority for buying, redeeming, or refunding Government Debt Securities and for paying interest on securities. This authority is delegated in part to the DMU. The issue and redemption of Government Debt Securities is managed by the CBI acting as the agent for the GoI.

111. **Central government’s contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and always approved by a single responsible government entity.** This rating assumes that no guarantee has been issued recently in the Government. Consequently a score of C is appropriate.

PI 18: Effectiveness of payroll controls

PI 18	Scoring method M1: (i) Degree of integration and reconciliation between personnel records and payroll data. (D) (ii) Timeliness of changes to personnel records and the payroll. (D) (iii) Internal controls of changes to personnel records and the payroll. (D) (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers. ©	D+
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(i) Degree of integration and reconciliation between personnel records and payroll data

112. **Reconciliation between establishment lists and MDAs’ payroll records occurs infrequently and integrity of payroll and personnel data is undermined** by the lack of complete personnel records and a comprehensive personnel database in the MDAs (see PI-16(ii) for discussion on in-year controls). Pre and post-transaction payroll control is weak. It has been reported that disbursement reconciliation in respect of deductions, transfers and ledger postings seems to be broadly acceptable in terms of process design. However, in practice it has proven difficult to determine how processes are actually implemented. Consequently, a score of “D” is given.

113. **Current payroll processes and procedures are not able to guarantee allocation of funds or that payments are not being made “ghost¹³” employees.**

Existing systems have also made it difficult to assess current and future liabilities of pension policies, since meaningful estimates require critical data on certain items, such as establishment numbers, ages, grades, length of service, and dependents and beneficiaries.

114. **MDAs predominantly use a manual payroll system**, however some computerized systems do exist, though they are unique stand alone and do not connect to other applications. The manual system in MDAs are either book based systems or book-based supported by spreadsheet or outdated database applications. The MoF uses an internally

¹² Implicit guarantees may have emerged with some project agreements.

¹³ A ghost employee may be a fictitious employee on the payroll one who is no longer employed (e.g. for death, retirement, resignation or termination)

developed Fox Pro system, while the Ministry of Industry and Minerals use an internally developed Access application. The Ministry of Oil uses a COBOL mainframe application developed in the 1960s.

(ii) Timeliness of changes to personnel records and the payroll

115. **Delays in processing changes to payroll and nominal roll are often significantly longer than three months** and require widespread retroactive adjustments. Mainly due the reasons mentioned in the previous and subsequent dimensions, timeliness of changes to records is seriously compromised. Consequently, a score of “D+” is given.

(iii) Internal controls of changes to personnel records and the payroll.

116. **The foundation for an effective establishment control system is in place** within the context of the annual budget process. However, the lack of computerized systems, and standard coding structures, compromises the integrity of both the manual and any computerized personnel database that is in place. This makes it difficult for the authorities to control changes and monitor and report on establishment compliance.

117. **Specific problems in payroll management have been identified** and include the following:

- MDAs use separate payroll applications, with only limited classification and reporting standards;
- Almost all civil servants are paid in cash and consequently pay dates vary from ministry to ministry to ease pressure on banking systems;
- Signature sheets are often not countersigned at the point of payment, nor are unclaimed funds routinely identified and returned to ministerial treasury departments;
- Instances of managers collecting salaries on behalf of employees have been reported;
- Related legislation is not clear with different interpretations being reflected by MDAs;
- The process for validation of payments is weak. Cash disbursement of salary though a three-person payment committee is the standard method. There is no standard process for returning unclaimed funds to the MoF;
- There is no common civil service employment number. Consequently, employee transfers require termination and rehiring and meaningful employee history is unavailable; and
- There is no standard coding structure, which causes data aggregation problems causing reporting to be a resource task.

Given these problems, a score of D is justified.

(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers

118. **Some partial payroll audits have been undertaken by the BSA and Inspector Generals**, who have identified significant problems identified above. MDA audit

procedures generally review monthly variances rather than undertake any form of systematic, random or compliance checks. The BSA has procedures for performance audits which involve more detailed analysis of payroll control (BSA Audit Directive 18). Some payroll surveys and analysis have also been commissioned by the World Bank and others on request of the Government. As discussed above, a civil service census is also underway, which should help provide the basis for improved controls and data and better payroll auditing. Consequently a score of C is appropriate

PI 19: Competition, value for money and controls for non-salary expenditure

PI 19	Scoring method M2: (i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold). (D) (ii) Extent of justification for use of less competitive procurement methods. (C) (iii) Existence and operation of a procurement complaints mechanism. (C)	D+
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(i) Evidence of the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold)

119. **Insufficient data exists to assess the method used to award public contracts.** Although it was stated in recently published regulations that open competition is one of the procurement methods to be used by Iraqi procuring entities, a score of “D” is assigned as data is not yet available on the number of contracts above the threshold procured on the basis of open competition.

(ii) Extent of justification for use of less competitive procurement methods

120. **Less competitive procurement methods such as direct contracting or single source selection should be used only in exceptional circumstances** such as for: i) standardization of equipment or spare parts; ii) proprietary equipment; iii) critical items related to performance guarantee; iv) and natural disasters. Contract extensions should also be limited to 15% in value. A risk assessment is needed on procurement processes within the context of current and changing security environment and existing and draft legislation. Moreover, guidance on when security conditions and other situations are sufficient reason for use of less competitive methods is urgently required.

121. **Regulatory requirements establish that open competition as the preferred method of procurement.** Justification for use of less competitive methods is however weak. Under the current implementing regulations, direct invitation requires a minimum of three bidders for invitation. This method is to be used when “warranted” by reasons such as “secrecy” or “need for speed of execution”. It is understood that these reasons are to be defined by the MoP in future instructions. Preliminary guidance issued

constitutes a significant fiduciary risk. The regulations also specify that single source is to be used only for the supply of goods or projects or for “specialized maintenance” projects and MDAs must first obtain “fundamental” approvals before commencing this form of procurement. It is unclear on what basis “fundamental approvals” would be given. Purchasing committees are used for commodities and services whose values are less than 50 million ID.

122. There are three procurement approval bodies that are required to assess justifications and processes followed for less competitive methods. 1) Executing Ministries and Provinces have “Tender Analysis and Recommendation Committee (TARC)”, which analyze tenders; and “Central Committees” chaired by Governors, deputies, and members of the concerned directorates. 2) ; Ministry of Planning and Development Cooperation promulgates procurement, contracting and investment budget execution regulations. 3) The High Contracting Committee reviews and approves proposed contracts above a certain threshold amount. Inspectors General and the Board of Supreme audit also undertake procurement audits. Information on number and type of justification issued is not yet available, although MoP have indicated that the security situation is often cited for justification of project delays and procurement method selection.

123. A score of “C” is be assigned to this criterion since justifications for use of less competitive methods are listed in the recently published regulation, although they are weak. Moreover data is not available to assess whether less competitive methods of procurement are justified in accordance with regulatory requirements required for a score of B

(iii) Existence and operation of a procurement complaints mechanism

124. The recently published regulations highlight the procurement complaints process with clear time frame for resolution of complaints. However, it has not been tested as there has been no procurement complaints submitted so far. Under Order 87, the MoP is given the role to make determinations on contractor protests and claims in accordance with existing regulations. Consequently a score “C” is awarded for this criterion.

PI 20: Effectiveness of internal controls for non-salary expenditure

PI 20	Scoring method M1: (i) Effectiveness of expenditure commitment controls. (D) (ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures. (C) (iii) Degree of compliance with rules for processing and recording transactions. (C)	D+
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(i) Effectiveness of expenditure commitment controls

125. No real expenditure commitment control procedures exist. Such controls as exist are based on liquidity management procedures, contract specification rules, sanctions and oversight. Legacy commitment controls have been weakened to facilitate

budget execution performance. The controls do not comprehensively cover all expenditures and they are occasionally violated. Consequently a score of “D” is appropriate

(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures

126. Verification rules for non-salary expenditure consist of a basic set of documentary and approval requirements. Investment budget verification guidance is issued, however, guidance on what constitutes appropriate documentary evidence is lacking. The MoP requires submission of all verification documentation and correspondence with contracting entities associated with an investment project.

Multiple approvals are required (including project manager, DGs, ministers, MoP and MoF) according to the type and value of expenditure payment. Verification rules for non-salary operational budget expenditure are based on pre-transaction audit method. Current information management systems are not sufficient to cope with the number of transactions required to improve verification control and compliance monitoring

127. Accounting (payment) controls for non-salary expenditure are also founded upon pre-transaction audit principles and consist of a basic set of compliance checks. Multiple approvals are also required, though approval requirements are limited. Payment control requirements are different according to payment type. For the investment budget for example, there are five different forms of payments: i) contract advances; ii) letters of credit; iii) allowable administrative costs; iv) payment of contractor invoices and return of bid or performance bonds. Investment budget payment controls consist of a basic pre-transaction review, which checks that: i) the project is in the budget; ii) sufficient funds are available; ii) the payment is consistent with the relevant contract; and iii) invoice is in the proper format. Checking that a competent person has signified that the goods have been received and that the service has been performed as expected, and that the creditor is correctly identified does not formally occur While key components of essential payment control systems are in place, current information management systems are not sufficient to cope with the number of transactions required to significantly improve payment control and compliance monitoring.

128. Other key non-salary controls are undeveloped. They include; i) procurement process controls (e.g. monitoring of appropriateness of procurement method); ii) rules for the prevention and detection of mistakes and fraud (internal and external audit are assessed in following indicators); iii) the safeguarding of information and assets (e.g. lack of guidance on asset registration); and iv) specification of quality standards for accounting and reporting. Some guidance has been issued on the requirement for the safe storage of information. There are rules for allowable expenses, incentives and bonus payments, however, documentation requirements and guidance on these is limited.

129. Non-salary expenditure control rules and procedures consist of a basic set of rules for processing and recording transactions. Multiple approvals at every stage of the transaction is often required. The rules are only partially relevant. It is evident that rules are understood generally by those directly involved in their application. Some rules and procedures may be excessive, such multiple approval requirements, while other controls are deficient, such as accurate identification of creditors and vendors.

Control rules are basically relevant to Iraq's situation, however, certain high risk points are not adequately monitored (e.g. letters of credit payments and verification of valid commitment). The system does not have an excessive number of financial controllers and there is only minimal computerization involved in processes. Accordingly, the control system may be inexpensive but the level of effectiveness is unclear. The score of "C" is appropriate

(iii) Degree of compliance with rules for processing and recording transactions

130. **Existing rules are generally complied in the majority of transactions**, but simple procedures are followed and the use of emergency provisions is believed to be frequent. Consequently a score of "C" is given. At the payment (accounting) control stage it is unclear whether all aspects of control procedures are properly followed. Compliance with liquidity management and payment controls rules are generally adhered to and monitored by the MoF. It is understood that MDA performance varies considerably between MDAs, within MDAs and Governorates. Central agencies report that there are compliance problems, due mainly to civil service experience, capacity or security constraints. In addition, there appears to be a consistent lack of identification and recording of contract vendors, which constitutes a significant fiduciary risk. Compliance with letters of credit payment procedures is a key cause of payment delays, although disputes on verification requirements are often cited. Assessment of compliance with other rules such allowable expenditures, return of bid bonds, advance payments is difficult due an absence of documentary evidence, however, reports by the Inspector Generals and the BSA indicate that compliance is low.

131. **Verification controls for investment budget are generally followed** although documentary evidence is often lacking. Furthermore, internal procedures differ due to diverse interpretation of guidance or lack of experience. Multiple verification approvals are required. This does necessarily increase assurance that services or goods have been delivered as expected. The quality of verification is uncertain due.

132. **At the verification stage of the operation budget, documentary evidence is also often deficient**, although the MoF does not require this for the operational budget since responsibility is delegated to MDAs, consistent with FML provisions.

133. **Compliance with other key non-salary controls is low**. It is understood that procurement processes often call on less complete methods. It is uncertain whether justifications are appropriate. Safeguarding of information and assets is weak. Compliance with existing standards for MDA accounting and reporting is inconsistent. There are rules for allowable expenses, incentives and bonus payments, however, documentation requirements and guidance is limited. While minor adjustments to budget allocations are frequent, the adjustment approval process is well administered (see the third dimension of indicator number 16). These other controls are key components of effective internal control systems.

PI 21 Effectiveness of internal audit

PI 21	Scoring method: M1 (i) Coverage and quality of the internal audit function. (C) (ii) Frequency and distribution of reports. (C) (iii) Extent of management response to internal audit findings. (D)	D+
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(i) Coverage and quality of the internal audit function

134. **According to Section 11 of the FML 95/2004, it is the responsibility of budget executors to establish arrangements for accounting and internal control of the transactions of spending units and sub-units under their jurisdiction.** The FML also empowers the Minister of Finance to prescribe internal control arrangements, accounting procedures, standards and timelines. The Minister may also issue special orders to spending units including all levels of sub-national government (SNG) for the submission of financial reports and final accounts. Within each agency, there is a Directorate that performs *ex-ante* control (or pre-disbursement “audit”). These Directorates are headed by a Director General who is meant to be independent of the minister concerned. S/he is responsible for ensuring that there is a budget allocation and of clearing each stage in the expenditure cycle (commitment and payment order) to ensure its regularity and legality according to prescribed criteria (correct documentation, proper application of procurement or wages rules, correct budget classification).

The Inspector General System

135. **The IG system in Iraq is modeled on that of the USA.** There are currently 37 IGs, of whom 31 are in ministries and 6 in other organizations like the Central Bank of Iraq. The IG is meant to provide regular assessments of the adequacy and effectiveness of the organization’s decision-making, risk minimization and internal control processes. The IG is also the main point of contact for Iraq’s Supreme Audit Institution, the Board of Supreme Audit (BSA). The IG Office is to provide information on the status of execution of its internal audit plan, and to co-operate with the BSA in ensuring follow-up of BSA audit recommendations. The IGs are responsible for conducting internal investigations within their organization when necessary. Cases of fraud, theft, embezzlement or corruption are ported to the Commission on Public Integrity (CPI). The IG’s office acts as the conduit for any organizational documents and assistance required by the CPI.

136. **Before 2004, there was no system of internal audit as such in Iraq.** There were General Inspectors in the previous regime, however, they were there more as informants for the regime, rather than internal auditors. The only equivalent office was a field audit unit operating within the Ministry of Finance Accounting Department. At the request of the Minister of Finance, it performed ex-post audits of selected ministries and other public entities.

137. **There are substantial capacity development needs in the IG departments.** Although they are operational in government departments and other bodies, there are serious concerns regarding their ability at their current stage of development to apply

modern internal audit practices and international auditing standards. Consequently, a score of C is awarded to this dimension of internal controls.

(ii) Frequency and distribution of reports

138. The Inspectors General issue reports with recommendations to the Minister, who may either accept or reject the report. Reports that address cases of fraud are required to be copied to the Commission of Integrity (the former Commission on Public Integrity). Score: C

(iii) Extent of management response to internal audit findings

139. Follow-up on IG reports appears to be limited. If the Minister rejects the report, there is no further action by the IG. Even if the Minister does accept the report and its recommendations, there is no follow up by the IG to see if the recommendations have been actually implemented. Score: D

Accounting, recording and reporting

PI 22: Timeliness and regularity of accounts reconciliation

PI 22	Scoring method M2: (i) Regularity of bank reconciliations. (C) (ii) Regularity of reconciliation and clearance of suspense accounts and advances. (D)	D+
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(i) Regularity of bank reconciliations

140. Reconciliation of accounts directly controlled by MoF is adequate. However, problems emerge with the regularity and quality of reconciliation of indirectly controlled accounts. Where MoF’s Accounts Department has direct control of bank accounts in terms of payments and deposits, monthly and full reconciliation is at a detailed level and usually occurs within 4 weeks. Reconciliation problems, such as timeliness and completeness of reports on accounts managed by MDAs and other entities, occur frequently. Problems experienced appear to be due to the delegated arrangements for reconciliation through trial balance¹⁴ reporting arrangements. The probable cause is that bank account statements are not submitted with trial balance reports for verification. This constitutes a serious fiduciary risk.

141. Reconciliations of most MoF managed bank accounts are conducted regularly on a monthly basis. Not all accounts are suitably reconciled and the monthly reconciliation process usually takes longer than 4 weeks. Quarterly reconciliation is usually materially complete within 8 weeks. Consequently a score of C is appropriate.

(ii) Regularity of reconciliation and clearance of suspense accounts and advances

¹⁴ Trial balance reporting is the traditional reporting format that reconciles recorded expenditures with bank account transactions.

142. **The GoI has a number of different types of suspense and advance accounts.** At the assignment level, suspense accounts are used by MoF to transfer appropriation allocations to MDAs or MoF managed Bank accounts. At the expenditure accounting level, MDAs use four types of suspense and advance accounts as follows: i) contract advances; ii) letters of credit iii) bid or performance bonds; and iv) petty cash. Suspense accounts are also held by MDAs and the MoF for Government projects financed or co-financed by the World Bank. DFI accounts are also a type of suspense account used by the Government for certain receipts, transfers and expenditure.

143. **Reconciliation of assignment suspense accounts takes place at least quarterly and often monthly.** These are generally completed within a month. Clearance of these accounts takes place annually in general, within around two months of the end of the year. Clearance of transfers to provinces and the KRG is unclear as the procedures for deeming final appropriations¹⁵ have not been finalized.

144. **Frequency of reconciliation of suspense accounts at the MDA expenditure accounting level is determined by the type of suspense account.** The reporting process is incorporated within the trial balance liquidity management system. Reconciliation of petty cash usually occurs on a monthly basis. Reconciliation of contract advances and performance bonds usually occurs on a quarterly basis. Clearance of these occurs at least annually within two months of end of period, although some accounts have uncleared balances brought forward.

145. **The frequency of reconciliation and clearance of suspense accounts for letters of credit (L/C) is uncertain.** Analysis of the letters of credit process has been undertaken. There are particular points in the process that are either: i) not clear ; ii) not clearly documented for accounting purposes; or iii) not well understood by those who are or should be involved.

146. **Reconciliation and clearance of most suspense accounts and advances take place annually in general,** within two months of end of year, but a significant number of these accounts have uncleared balances brought forward. Reconciliation and clearance of high valued suspense accounts, such as those associated with L/C's, takes place annually with more than two months' delay or less frequently. Consequently a score of "D" is appropriate.

PI 23: Availability of information on resources received by service delivery unit

PI 23	Scoring method M1: i) Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (D)	D
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¹⁵ For example, rules governing population and revenue outturns, reporting obligations and end-of-year adjustment process.

(i) Collection and processing of information to demonstrate the resources that were actually received by the most common front-line service delivery units

147. **Routine data collection systems are not yet in place that provide reliable information on all types of resources received in cash and in-kind by primary schools or primary health clinics.** While relatively reliable data exists on budgets and expenditures for MDAs at the provincial level, obtaining and reporting on more detailed information is either absent or too resource intensive to collate. At the school and hospital level, data is readily available on the amount of salaries allocated and spent on teachers and health care workers. However, data on allocations and expenditures to these service delivery units for critical operating expenditures, such as pharmaceuticals, medical supplies, text books and equipment is not readily available. While MDAs do hold this type of data in some form, systems are not in place to produce timely and reliable information on these important resource flows.

148. **Investment budgets and expenditures are available for school and hospital rehabilitation projects** supported by development partners. However, budget, disbursement and expenditure reports from development partners are not in the appropriate form, either in terms of the time-period (i.e. fiscal years) or in accordance with economic, functional or provincial classification. The GoI's investment budget for schools and hospitals is available at the project level. While data is maintained by both the MDA concerned and the MoP, reports on these allocations and out-turns are not yet published.

149. **MoP is developing two investment project reporting systems** that are well placed to capture and report on investment budget projects at the service delivery unit level. The Development Assistance Database (DAD) has been "operational" since 2005. Unfortunately the data is outdated as there has only been one effective update (completed in 2006). The Capital Budget Reporting and Tracking (CBRT) system is a project management tool that is founded on legacy project management systems. The MoP is also considering incorporating added functionalities, such as procurement tracking and consolidated investment budget and execution reporting. It is developing quickly and there are encouraging signs that officials at the provincial level and even service delivery units will be able to view and update data. Whichever system becomes operational or the primary source of information, the classification system will need to be aligned with the MoF's and BSA's classification and accounting standards. This will facilitate improved resource allocation and reporting as the ministers for Finance and Planning will be able to determine sector allocations, project inconsistencies and medium term financial implications of such projects.

150. **Comprehensive or sample surveys have not yet been undertaken to assess the level of resources received in cash and in kind by either primary schools or primary health clinics.** While a poverty assessment survey is underway, it will not provide sufficient information on resource flows to service delivery units in the field.

151. **A score of "D" is appropriate, given that there remains no comprehensive system of data collection** that is operational for the reporting of resource flows to key

service delivery units, and that education and/or health PETS have not yet been undertaken

PI 24: Quality and timeliness of in-year budget reports

PI 24	Scoring method M1:	D+
	(i) Scope of reports in terms of coverage and compatibility with budget estimates. (C)	
	(ii) Timeliness of the issue of reports. (D)	
	(iii) Quality of information. (C)	

(i) Scope of reports in terms of coverage and compatibility with budget estimates

152. Comparison with budget is possible for most administrative and economic classifications of the budget, but comparisons are only possible at the payment stage. Given current financial management systems, comparison of expenditure commitments and the budget is not yet possible. MDAs provide “trial balance” reports, which separate expenditures for employee compensation, goods and services and non-financial assets. MoF is directly responsible for producing in-year reports for almost all the other economic expenditure classifications (i.e. Interest, Subsidies, Grants, Social Benefits, Other Expenditures and Pension payments). The appropriation to the KRG is treated essentially as an unconditional block grant, which does not require reclassification in the GoI’s in-year or out-turn reports¹⁶. The investment budget is aggregated in the annual federal budget. Consequently, it is not possible to compare budget and in-year performance at a more detailed economic classification level for investment budget expenditures (e.g. acquisition of non-financial assets and consultancy projects). Overall then, a score of “C” is appropriate

(ii) Timeliness of the issue of reports

153. The in-year reporting process follows a monthly cycle through the MoF’s “trial balance” reporting method, although more complete reports are prepared quarterly. Quarterly reports are supposed to be presented to the High Economic Committee within 8 weeks of end of quarter but longer delays are common... The MoP also produces quarterly reports for the High Economic Committee on Investment Budget execution. The accounting treatment reflected in these reports, however, appears to differ from MoF standards. MoP information is sourced from MDAs on request of the MoP. The timeliness of MoF and MoP consolidated reports is determined by the timeliness and completeness of reports from MDAs and deconcentrated MoF provincial treasuries (and currently operates with a two-month time lag). A score of D is appropriate

(iii) Quality of information

154. There are concerns about the accuracy of information in quarterly reports. Data quality concerns are associated with: i) fragmentation of the investment and

¹⁶ Reconciliation of final deemed appropriations to the KRG is needed and depends on final revenue outturns and revenue sharing modalities and agreements.

operational budgets; ii) opaque accounting treatment for certain expenditure items (including suspense accounts); and iii) the implementation strategy for the roll-out of the GoI’s new GFS-based classification system. The concerns, however, do not substantively undermine the usefulness of reports.

155. Fragmentation of the investment and operational budgets is causing some duplication in the reporting of investment expenditures. While instructions have been issued to minimise the risk of fragmentation problems in reporting, it is evident that MDAs report regularly to the MoP using different methods for expenditure accounting. Moreover, it is clear that the High Economic Committee relies on these MoP produced reports to initiate corrective action. Differences in accounting treatments include differences in time periods for reporting (MoP often receives reports for different time periods for consolidated reporting) and some differences in economic classifications associated with the acquisition of non-financial assets.

156. There are concerns that investment expenditure reports include a mixture of commitments and actual expenditures. Apparently, values of signed contracts may be inadvertently included as expenditure in MoP reports, due to opaque guidance. This has been evident with substantive differences between MoF unified reports and MoP reports.

157. The implementation arrangements for the roll-out of the new GFS based classification system is having unintended consequences for perceived data quality. While the legacy classification system is still being used by MDAs, the MoF is producing in-year reports using the new classification system. This does not materially impact on MDA operational expenditures, since the MoF is responsible for executing and reporting around 85% of the former “transferred expenditures¹⁷” budget chapter. Nevertheless, the lack of separation and clarity associated with the accounting of investment expenditures has increased uncertainty of data quality and has extended delays during the consolidation process.

158. A score of “C” is considered appropriate, since reports are produced monthly and quarterly. Although some concerns are emerging about processes that increase the risk of substantively inaccurate data being used, these concerns do not yet fundamentally undermine the basic usefulness of the reports.

PI 25: Quality and timeliness of annual fiscal statements

PI 25	Scoring method M1: (i) Completeness of the financial statements. (C) (ii) Timeliness of submission of the financial statements. (C) (iii) Accounting standards used. (D)	D+
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¹⁷ . Interest, Subsidies, Grants, Social Benefits, Other Expenditures (e.g. contingency reserve and compensation payments to Kuwait) and Pension payments.

(i) Completeness of the financial statements

159. **Section 11.7 of the FML** outlines **the scope of information of annual financial statements**. The section requires the following to be included:

- External audit report from the Board of Supreme Audit;
- A statement of differences between budgeted and executed receipts and payments and on the financing of any deficit or the use of any surplus;
- *A statement of spending from contingency reserves;*
- *Opening and closing balances of the Treasury Consolidated Account and a summary of movements for the year;*
- *A statement of all federal government borrowings for the year, and the total debt outstanding, including any payment arrears;*
- *A statement on federal government guarantees issued during the fiscal year;*
- *A statement on all borrowings by regional governments and governorates;*
- *A statement on outstanding amounts on capital contracts and retentions (carryovers) due on contracts;*
- *A statement on letters of credit entered into for which funds have been placed but for which goods have not been received; and*
- *A statement on all guarantees by regional governments and governorates.*

160. **Section 5.4 of the Law** requires that **the BSA be provided with additional information** on the operations of the petroleum revenue account. Since the President of the BSA is the chair of the COFE, the BSA is effectively provided with timely access to this information. Section 14 outlines what information is required to be delivered to the BSA with the financial statements and include the following:

- Approved federal budget and any supplementary budgets, and any accompanying documents (e.g. in-year adjustments);
- Results of all internal audits;
- Quarterly and annual reports on loans, borrowings, guarantees, and debt;
- Final accounts of public corporations and the results of all audits; and
- Any other documents, information and explanation requested by the Board of Supreme Audit in connection with the performance of its audit functions.

161. **A consolidated government statement is prepared annually**, although it is not fully complete. Complete information on all assets and liabilities is not provided in the annual consolidated financial statement. In addition, information on revenue, expenditure and bank account balances is not always comprehensive as some accounts remain unclosed due to ongoing investigations into unresolved discrepancies associated with trial balance reports. These omissions, however, are not likely to be material. The reconciliation processes for bank balances and suspense accounts are a key area of concern (see PI-22 for more information). Other information required by the FML, as indicated by *italics* in the list above, are not yet included in the reports. Consequently a score of “C” is considered appropriate

(ii) Timeliness of submission of the financial statements

162. **Section 11.6 of the FML requires that annual final accounts of the federal budget be submitted to the BSA for external audit by 15 April** of the succeeding year. This timeframe of 3½ months is very tight. Provision of annual financial statements for external audit within six months is considered best practice.

163. **Annual financial statements are provided to the BSA within 6 months of the end of the fiscal year.** However, the statements are often not sufficiently complete as a number of MoF initiated clarifications and corrections are made after the statements have been transmitted to the BSA. For the 2004 and 2005 fiscal years, substantively final statements were provided within 15 months. For 2006, substantively final accounts were provided to the BSA within 10 months. Consequently, a score of “C” is considered appropriate

(iii) Accounting standards used

164. **Annual financial statements are presented in a consistent format over time,** although with only limited disclosure of financial reporting and accounting standards followed. While accounting standards have been established for the private sector, they have not yet been formally established for public sector accounting.

165. **Iraq’s public sector accounting and reporting standards have been developed over many years** and have been reflected in different subordinated legislation, which has since been rescinded, and ad-hoc guidance. The move to GFS based classification system in 2007 has also delayed the adoption of national standards for public sector accounting and financial reporting and introduced inconsistency in the presentation of financial statements. It should be noted that the GoI reclassified appropriations for the 2006 budget according to the new classification system. This facilitated comparison of the 2006 and 2007 budgets. Consequently, a score of “D” is appropriate.

External scrutiny and audit

PI 26: Scope, nature and follow-up of external audit

PI 26	Scoring method M1: (i) Scope and nature of audit performed (including adherence to audit standards) (B) (ii) Timeliness of submission of audit reports to the legislature (D) (iii) Evidence of follow up on audit recommendations (D)	D+
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(i) Scope and nature of audit performed

166. **Iraq’s SAI, the Board of Supreme Audit (BSA) is widely recognized as the country’s premier public accountability institution.** It has a long history, having been established in 1927, well-trained staff and reasonable capacity to carry out its mandate. Recognizing the need to adopt modern auditing approaches, the BSA invests significant resources in research and development and is an active member of international and regional SAI bodies, such as INTOSAI and ARABOSAI. Although these activities help to mitigate the adverse effects of years of the international isolation

of Iraq, BSA top and senior management acknowledge the need for support from the international development community in terms of applying contemporary government audit standards, practices and techniques. With this in mind, donors such as the UNDP and World Bank have been supporting BSA’s strategic planning and capacity development programs.

167. **The BSA’s mandate is far-reaching.** It is empowered to conduct the full range of audits, namely certification, financial, compliance and value for money (VFM)/performance audits. Its remit extends to sub-national as well as national government and embraces public enterprises as well as civil society organizations in receipt of public funding. It covers all sectors dealing with the public funds whether income or expenditure. Discussions with the BSA’s top management indicate that all these audits are carried out in a carefully planned manner and subject to stringent technical quality control from the centre. There are some constraints, however, caused not least by the harsh security environment in which the BSA has been operating in recent years. In particular, BSA’s work at the sub-national level has been hampered by difficulties in accessing records and personnel in certain parts of Iraq. There are also specific issues relating to the Kurdistan Regional Government, where currently two separate BSAs operate, each of them suffering from a severe dearth of experienced auditors. These two organizations are scheduled to merge shortly, but they will continue to suffer from lack of capacity for the foreseeable future. Overall, a score of “B” is justified.

(ii) Timeliness of submission of audit reports to the legislature

168. **While the competence of the (national) BSA to discharge its functions is broadly sound,** there has been, and continues to be a major weakness in Iraq’s public accountability arrangements in terms of the timeliness of submission of audit reports to the Council of Representatives. No annual audit report has not been submitted to the COR for the past 3 years thus preventing the legislature from exercising its essential scrutiny function over the Executive. A score of “D” is therefore appropriate

(iii) Evidence of follow-up on audit recommendations

169. **Follow-up action to audit reports by the Executive is a critical link in the public accountability chain.** Given the absence of timely audit reports referred to above, this aspect of public accountability needs to be significantly strengthened. It is encouraging, therefore to note, that the BSA has expressed a strong interest in working with civil society to promote social accountability, a topic that has been discussed in two recent World Bank sponsored workshops with senior officials from the national and Kurdistan BSAs. For now, however, a score of “D” is merited.

PI 27: Legislative scrutiny of the annual budget law

PI 27	Scoring method M1: (i) Scope of the legislature’s scrutiny (C) (ii) Extent to which the legislature’s procedures are well-established and respected (D) (iii) Adequacy of time for legislature to respond to budget proposals (B) (iv) Rules for in-year amendments to the budget without prior legislative approval (D)	D+
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170. **Under the Constitution, legislative authority is vested in two bodies; the Council of Representatives (CoR) and the Council of Union.** The CoR consists of 275 members who are elected for four year terms. The CoR approves federal laws, oversees the Executive, ratifies treaties, and approves nominations of specified officials. It elects the president of the republic, who selects a prime minister from the majority coalition in the Council¹⁸. The Council of Union, or Federation Council (Majlis al-Ittihad), is to consist of representatives from Iraq's regions. Its precise composition and responsibilities are not defined in the Constitution and are to be determined by the CoR.

(i) Scope of the legislature's scrutiny

171. **The legislature's review covers details of expenditure and revenue,** but only at the stage where the Annual Budget Bill has been tabled by the Government. The Finance Committee reviews the Budget and provides a report to the CoR, which is discussed at the 2nd Reading of the Annual Budget Bill. The legislature's review covers some fiscal policies on an ad-hoc basis through reports from sector specific committees. Some fiscal policy questions are also raised by various CoR members not on a committee. Budget documentation does make it difficult for the CoR to undertake detailed analysis. The reviews do not include a detailed assessment of the Government's medium term fiscal framework or medium term fiscal priorities as a medium-term perspective is not yet included in the Budget papers and do not form part of the Annual Budget preparation process. While the CoR does review some Government programs, such as social security (PDS and SSN) and fuel subsidization, more specific reviews of program or government function (e.g. primary school education, emergency health care and maternal health) can not be readily undertaken given the current content and structure of the Annual Budget papers. Consequently, a score of "C" is considered appropriate.

(ii) Extent to which the legislature's procedures are well-established and respected

172. **The CoR has 24 standing committees; 10 providing oversight functions and 14 providing more sector specific review functions** The CoR has two primary committees for the review of the annual budget law, although all the standing committees have an interest in reviewing aspects of the Budget. While the committees' responsibilities cut across each other, the Economics, Investment and Reconstruction Committee is primarily responsible for reviewing fiscal and economic policies, while the Finance Committee is primarily responsible for reviewing budget allocations and deficit financing strategies.

173. **The committees are formally provided with the Annual Budget Bill after the Bill has been introduced by the Government** and after its first reading. The Committees then formally meet to discuss and agree recommendations to be presented at the plenary for the 2nd reading (see the Bylaw of Iraqi Council of Representatives). During the 2nd readings, CoR members have an opportunity to raise issues and ask the Minister for Finance specific questions concerning the Bill.

174. **The Finance and Economic Committees do not yet have procedural documents that guide the review process.** Tools and check lists for financial analysis have not yet been developed to support the Committees during review. Coordination arrangements with other committees, including the Legal, Oil and sector committee, are informal.

¹⁸ During an initial period, a three-member Presidential Council elected by the Council of Representatives will carry out the duties of the president of the republic.

175. **Some procedures exist for the legislature’s budget review, but they are not comprehensive** and only partially followed. The Bylaw of Iraqi Council of Representatives is the only procedural document that guides review arrangements. The Bylaw includes internal organizational arrangements and establishes standing committees. The procedures also outline crucial reporting and negotiation procedures within the CoR and between the CoR, its committees and the Government. A score of “C” is appropriate.

(iii) Adequacy of time for the legislature to respond to the Government’s proposals

176. **The time periods to which the CoR is to provide a response to budget proposals are enshrined in the FML and the By-Law of the Iraqi CoR.** Under Section 6.2 of the FML the Government is to submit in the month of May to the CoR “a report on the priorities for fiscal policy for the next fiscal year, including the proposed total limit on spending and the limits for each individual spending unit”. The Budget Call Circular (BCC) is to be issued in June. This provides the CoR between 1-2 months to review fiscal aggregates early in the budget preparation cycle, which is sufficient time for the CoR to provide comments to the Government prior to the issue of the BCC. Under Section 6.8 of the FML the Government is also required to submit to the CoR by 10 October the draft Annual Budget Bill. This gives the CoR up to 2 ½ months for review of detailed budget estimates. Under Article 22 of the By-law of Iraqi CoR on Plenary Meetings, the CoR is to convene and continue sitting until the Annual Budget is approved.

177. **Since 2004 the CoR has had on average just less than 2 months to consider detailed budget estimates** prior to approval of the Annual Budget Law (see Table 27). The CoR has not yet been provided with fiscal aggregates early in the budget preparation cycle in any fiscal year. Given that the CoR has had at least one month to review the budget proposals, and legislation provides at least 2 months for review of annual budget proposals and early access to fiscal aggregates, a score of “B” is appropriate

Table 27: Duration from submission of the budget papers to the CoR to approval

Budget Year	Draft Budget Transmitted to the CoR (Est)	Budget Approval Date by CoR (Est)	Duration (Months)
FY08^	14 Nov 2007	07-Jan-08	1.8
FY07	14 Dec 2006	08-Feb-07	1.9
FY06	01 Dec 2005	28-Jan-06	1.9
FY05	20 Nov 2004	12-Jan-05	1.8

(iv) Rules for in-year budget amendments by the Executive

178. **Rules for in-year budget adjustments without ex-ante CoR approval are clear.** These are contained in the FML and temporary amendments reflected in the 2007 Budget Law and supported by issued instructions. Section 9.8 of the FML provides the scope and limits to in-year adjustments. Essentially, the laws provide the following conditions for in-year adjustments:

- a) a maximum of 5% (10% as temporarily amended by the 2007 Budget Law) of an MDA’s total appropriation (annual or supplemental) can be reallocated to another MDA providing that no funds are reallocated to another MDA’s investment budget;

- b) a maximum of 5% of an MDA’s total appropriation can be reallocated within the operational budget providing that no funds are reallocated from the MDA’s investment budget for this purpose;
- c) a maximum of 5% of an MDA’s total appropriation can be reallocated to the MDA’s investment budget; and
- d) a maximum of 5% of the non-interest Budget can be provided to MDAs for urgent and unforeseen expenditures financed by the contingency reserve (the 2007 Budget Law introduced a 25 billion ID limit for each case);
- e) On a provisional amendment basis to the FML, an MDA’s investment budgets can be reallocated to any MDA’s investment budget¹⁹ if the MDA fails to execute 25% of their allocations by the end of the first half of the 2007 fiscal year (projects delayed due to security constraints are exempt); and
- f) A supplementary budget can be introduced to the CoR for more significant in-year adjustments “*only on the basis of a significant and unexpected change in economic circumstances or national priorities*” (FML Section 7.5).

179. **Clear rules exist for in-year budget amendments by the Government and are partially respected.** Temporary provisions, however, allow extensive administrative reallocations. The increase of 5 percentage points to 10% for the amount an MDA’s appropriation can be reallocated to another MDA is considered high. The FML’s provision is consistent with international standards (item “a” above). Similarly, the theoretical reallocation of an MDA’s total investment budget should it not have executed 25% by mid-year provides excessive authority for reallocation without ex-ante approval by the legislature. Expansion of the expenditure without ex-ante approval is not allowed and is respected (see PI 16.iii). There appears to be no practice of submitting supplementary budgets to the CoR for its approval. Consequently, a score of D is given.

PI 28: Legislative scrutiny of external audit reports

PI 28	Scoring method M1: (i) Timeliness of examination of audit reports by the legislature (D) (ii) Extent of hearings on key findings undertaken by the legislature (D) (iii) Issuance of recommended actions by the legislature and implementation by the executive (D)	D
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180. **Authority and requirements for legislative scrutiny of the external audit reports is contained in the Constitution, Bylaw of the CoR, the FML and BSA Law.** Article 61 of the Constitution states that the CoR is the competent authority to monitor the performance of the Government. Section 11.6 of the FML requires that the BSA’s external audit report (and final accounts) for a specific fiscal year be submitted

¹⁹ The Law is silent on whether funds can be transferred to operational budgets in this instance.

to the CoR by June 30 of the follow fiscal year. Section 11.7 specifies the details that need to be included in final accounts. Section 11.8 requires that after the CoR has approved the final accounts (and considered the BSA’s audit report) that the final accounts “*be published in the Official Gazette and made publicly available*”. Section 14 of the FML requires the Minister of Finance to provide certain information to the BSA to facilitate external auditing. Article 31 of the Bylaw of the CoR requires the CoR to approve the final accounts (and review of external audit reports). Article 92 of the Bylaw also establishes the CoR’s Integrity Committee as being responsible for reviewing, monitoring and following up on audit reports. Under Article 3.4 of BSA Law of 1990 (and Section 2.5.5 of CPA Order 77/2004:) the BSA is to establish procedures for preparing and submitting to CoR, the BSA’s Annual Plan and Annual Report within 90 days of the end of each fiscal year²⁰. These reports alert the CoR to the non-finalization of final accounts and audits as appropriate.

181. At the time of writing, external audit reports and final accounts have not been tabled with the CoR. Consequently, examination of audit reports by the legislature does not take place, there are no in-depth hearings conducted by the legislature and there are no formal recommendations being issued by the CoR. A score of “D” is therefore appropriate for each of the three dimensions on timeliness, extent of hearing and issuance of recommendations

Donor practices

D 1: Predictability of direct budget support

D 1	Scoring method M1: The actual disbursement fell short by more than 15% in at least two out of the past three years.	Not rated
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182. In 2003 and 2004, Iraq received less than 1% of assistance in the form of direct budget support. Since then, Iraq has not received any direct budget support (see Table 28). When Budget support was provided, fiscal forecasts were not given to the GoI, which was consistent with donor pledging and budget arrangements at the time.

Table 28: Direct Budget Support – Committed and Disbursed by Fiscal Year (USD 'm)

Assistance Type/ Donor	Thematic Area	2003		2004		2005		2006	
		Com.	Dis.	Com.	Dis.	Com.	Dis.	Com.	Dis.
Direct Budget Support									
Korea	Governance and Democracy	4.7	4.7	-	-	-	-	-	-
Spain	Economic Development	-	-	5.0	5.0	-	-	-	-
Total Assistance		1,078.0	361.9	4,574.2	3,237.3	4,105.6	3,544.1	4,869.2	3,146.1

Source: DAD

183. Iraq’s development partners do not yet provide budget estimates for disbursement of project aid at stages consistent with the government’s budget calendar or in a breakdown consistent with the GoI’s budget classification. Major donors also do not provide budget estimates for disbursement of project aid for the GoI’s coming fiscal year, nor do they provide this information at least three months prior its start. Development partners do provide annual updates on commitments and disbursements, although reporting is not consistently classified. Given the lack of budget support, this indicator is not rated.

²⁰ Article 5.2.1a of BSA Draft Law 2005 extends the reporting deadline to the CoR from 90 days to 120 days at the end of each fiscal year.

D 2: Financial information provided by donors for budgeting and reporting on project and program aid

D 2	Scoring method M1: (i) Completeness and timeliness of budget estimates by donors for project support (D) (ii) Frequency and coverage of reporting by donors on actual donor flows for project support (D)	D
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(i) Completeness and timeliness of budget estimates by donors for project support

184. **Iraq’s development partners do not yet provide budget estimates for disbursement of project aid** at stages consistent with the government’s budget calendar or in a breakdown consistent with the GoI’s budget classification. Major donors also do not provide budget estimates for disbursement of project aid for the GoI’s coming fiscal year, nor do they provide this information at least three months prior its start. Development partners do provide annual updates on commitments and disbursements, although reporting is not consistently classified. Consequently, a score of “D” is appropriate.

(ii) Frequency and coverage of reporting by donors on actual donor flows for project support

185. **Iraq’s development partners do not provide quarterly reports within two month of end-of-quarter on all disbursements made** for at least 50% of the externally financed project estimates. Nor do they provide information consistent with the GoI’s budget classification system. Consequently, a score of “D” is appropriate

D 3: Proportion of aid that is managed by use of national procedures

D 3	Scoring method M1: Proportion of aid that is managed by use of national procedures	D
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186. **National procedures are bypassed** for almost all development assistance projects and programs. Development partners are not yet using the same national procedures used for Government funds for banking, authorization, procurement, accounting, audit, disbursement and reporting. Some progress towards the use of banking, authorization and auditing procedures has been achieved. For example, the World Bank uses Government Bank accounts for project special accounts (advance accounts), which are opened in accordance with MoF standards. The MoP and the ISRB authorize both Government and Donor investment projects, although the systems are different for donor projects. The BSA is now becoming increasingly responsible for auditing development partner projects and work is underway for the BSA (through the COFE) to take over oversight of the DFI from IAMB. Iraq’s development partners are working to strengthen procurement arrangements, which should allow greater use of national procurement procedures once new legislation and systems are operational.

187. Government funds are channelled into donor systems. Through the DFI, special arrangements are established that allow Government funds to be used according to non-national systems. Although this is understandable given the need to execute a massive budget, such an approach weakens institutions and enshrines potentially inappropriate practices for an Iraqi context.

Country specific issues

188. **Two key PFM issues in Iraq are worthy of emphasis, namely oil revenue management and capital investment budget implementation.** In terms of oil revenue management, at this juncture the Development Fund for Iraq (DFI) plays de facto the role of an oil fund. All proceeds of export sales of petroleum, petroleum products and natural gas from Iraq are deposited into the DFI. Oil revenues above the estimated price set in the budget accrue to the DFI. However, the decision-making process regarding the use of all the money that accrues to the DFI over that which goes into the budget is not clear. In similar situations, several countries dependent on hydrocarbon revenues have smoothed the revenue streams that finance public expenditures by establishing oil stabilization funds, or sovereign wealth funds. Others have set up heritage funds that pass on proceeds from natural resources to future generations.

189. **Discussions about creating such a fund are underway in Iraq but are tied to the larger discussion of how revenues will be shared.** According to the Constitution strategic policy-making is a shared power between the federal level and oil-producing governorates and the regions. Many federations with significant natural resource revenues such as Canada, US, Australia and Russia, provide states with extensive ownership rights, with the federal government playing a leading and central role in all other salient aspects in relation to natural resources. The GoI has yet to decide whether these revenues will be used to minimize the transmission of oil price volatility to fiscal policy i.e. establish a stabilization fund, or whether it will act as a savings fund and address inter-generational issues. Nor is it clear whether the funds in the DFI are being invested such that benefits are maximized. At present, the Committee of Financial Experts audits the DFI. But the audit objectives are fiduciary in nature with no focus on ensuring that the resources are effectively managed. Moreover, several past audits of the DFI have pointed out concerns regarding inadequate controls over Iraq's oil and other aspects of the DFI's operations.

190. **Budget execution is constrained by a range of bottlenecks in the capital investment budgeting system.** These stretch from procurement and contract management through commitment, verification and payment to oversight. There have also been wide divergences in budget execution rates between ministries and between governorates. Only the relatively stable and more secure region of Kurdistan has been able to achieve a high level of budget implementation. One factor that does not appear to be a constraint at the national government level is cash liquidity. The evidence suggests that a large amount of cash is actually being drawn down from the DFI in New York and advanced to government spending units. However, the money is then not being spent; instead it has led to very large idle balances in the bank accounts of spending units.²¹ Given the crucial importance of effective budget execution in terms of the delivery of essential public services, this area of PFM must be a priority for reform. The key issues are discussed in detail in chapter 2 of this report.

²¹ These have been estimated at ID 9.5 trillion at end-2007 (12 percent of GDP). equivalent to over US\$7.5 billion

191. **One of the most significant challenges facing the GoI is to improve the integration of capital and recurrent budgeting.** This common problem in PFM results in insufficient attention being paid to the recurrent costs of capital schemes and therefore significant difficulties in operating and maintaining expensive capital assets. Institutional arrangements are found to be important, with responsibilities for different aspects of budgeting being divided between the Ministry of Finance (MoF) and the Ministry of Planning (MoP). In Iraq, these difficulties are enhanced by large parts of the investment budget being financed and executed outside the budget by donors.

Government reform process

192. **The strategic context for a PFM reform process has been set by the International Compact for Iraq (ICI).** This provides a firm foundation for a Government-led reform process that can be supported in a sustained and integrated manner by Iraq's international development partners. As a basis for monitoring progress, detailed actions are set out in the Joint Monitoring Matrix (JMM) that supports the ICI. One major component of the JMM concerns the effective management of public resources in the interests of the people of Iraq.

193. **Within this component, the GoI commits itself to the objective of aligning Iraqi PFM and procurement system with sound international practice.** In order to establish the analytical framework within which PFM reform can take place, the GoI has been working as a priority action with the World Bank to complete this PEIA. to evaluate the performance of the national PFM system as a basis for prioritization of PFM reform programming.

194. **In the JMM, the GoI undertakes to achieve an integrated and comprehensive budget and increase its strategic content.** In support of this objective, agreed priority actions included the following:

- By end 2008, assign primary responsibility for all aspects of budget management to the MoF and clarify the role of other agencies
- By end 2008, capture in the budget all significant revenues and expenditures, including all subsidies and donor flows
- By end 2009, integrate the recurrent and investment budgets and establish a Treasury Single Account (TSA)

195. **Several donors have been providing support to PFM reform and capacity development over the last three or four years.** These include the International Financial Institutions, the United Nations, the United States, the United Kingdom and the European Commission. Much of the multilateral aid has been channeled through the International Reconstruction Fund Facility for Iraq (IRFFI). The US Government has worked on a range of PFM issues through the US Treasury, US Agency for International Development (USAID), State Department and Department of Defense, while the UK Government through its Department for International Development (DFID) has been actively involved in economic management. The UNDP has managed a program of support to the Board of Supreme Audit as well as providing support to anti-corruption initiatives. The World Bank has provided a number of workshops on specific aspects of PFM. The IMF has been providing technical assistance in support of its Stand By Facility. The need now is to co-ordinate these initiatives under a coherent program of support to a GoI led PFM reform strategy and action plan.

196. **In designing such a program, careful attention needs to be paid to the unusually difficult circumstances that face a fragile state like Iraq which has been so severely affected by conflict since 2003.** Many crucially important public institutions have been devastated by the destructive effects of war and insurgency on their capacity. Large numbers of key staff have been lost to the Iraqi public service. A sustained effort over the medium term backed by Iraq's international development partners will be necessary to rebuild the capacity required for a well performing PFM system. This will require appropriate incentives to help create an enabling environment for PFM modernization.

197. **The area of public financial management (PFM) requires significant reform.** The Government of Iraq's (GoI) budget lacks realism and credibility as spending on current expenditures is rising rapidly while capital budget implementation remains slow. The quality of expenditure reporting is uncertain and independent audits are not yet available.

198. **Weak governance, including poor PFM, continues to weaken the ability of the state to deliver the public goods necessary to support human development.** Since 2003 Iraq has made limited progress in reforming public expenditure policy and management, yet in order to implement an improved development agenda, Iraq will have to make much more progress on a number of key fiscal and institutional challenges. Weaknesses in the PFM system not only have high costs in terms of allocative and operational efficiency but also create unacceptably high levels of fiduciary risk to public funds. The cash-based payments system has emerged as a major constraint. Increasingly, budget execution has suffered from delays and an unpredictable release of funds, undermining operational planning and resulting in a likely build-up of arrears. The system is plagued by deficient accounting and reporting systems, leading to a weak control environment. The GoI will need to focus on improving budget execution, cash management, and the control environment, as well as strengthening tax and oil revenue administration.

199. **The GoI has demonstrated its commitment to improving public sector governance by putting PFM issues at the heart of the socio-economic pillar of the International Compact for Iraq.** Moreover, the GoI identified the World Bank's Public Expenditure and Institutional Assessment (PEIA) as a priority action under the Compact's Joint Monitoring Matrix (JMM) and has completed the workshops in line with the JMM benchmarks. The PEIA is intended to establish the foundation for the formation of a well structured Government-led medium-term PFM reform program.

200. **It is hoped that a sector-wide approach (SWAp) in PFM can be established through the ICI and the PEIA.** Development partners (DPs)—AusAID, Canada, DFID, the EC, IMF, Italy, JBIC, Poland, USAID, UNDP, and the WB—have indicated a willingness to work more closely with the Ministry of Finance and Ministry of Planning to support the development of a Public Financial Management Reform Program (PFMRP), which will serve as the common reform program endorsed and supported by all partners in PFM. Moreover, the desire to work jointly in a SWAp—via a Partnership Principle Agreement that is being explored—to coordinate support in order to minimize transaction costs, improve the overall quality of TA provision, and to “speak with one voice.” It is envisaged that through a PFM development partners working group, joint monitoring of progress against an agreed PFM performance management framework is achievable.

201. **The strategic level objective of a GOI-owned medium-term PFM reform program** would be to install much higher standards of management, accountability, efficiency, and effectiveness in the mobilization and utilization of all government financial resources. The reform program would aim to accomplish this objective by:

- making the budget credible as a management instrument;
- improving financial control and internal accountability; and
- making the budget a reliable instrument of pro-poor policy implementation.
- improving public and parliamentary scrutiny of public financial management

202. **It is suggested that the primary objective of the first phase (or “platform”) of the proposed Public Financial Management Reform Program should be to establish a more credible budget.** In establishing credibility, measures would be introduced that are designed to:

- Improve Budget Preparation;
- Improve Realism and Sustainability of the Budget;
- Facilitate Budget Execution;
- Improve Reporting;
- Strengthen Oversight;
- Develop PFM Capacity; and
- Improve Coordination, Monitoring and Evaluation.

203. **The program will build on the PEIA work**, which is intended to establish the foundation for the formation of a well structured Government-led medium-term PFM reform program. International experience emphasizes the importance of a properly sequenced and prioritized reform program. Promising results are emerging in some countries from the application of what has become known as the “Platform Approach” to be followed PFM reform programming. Applying this approach in Iraq would support the GoI in establishing a long-term vision for Iraq’s PFM system and would aim to implement a package of measures or activities designed to achieve increasing levels (‘platforms’) of PFM competence over a manageable timeframe. Effectively this is a “building blocks” approach under which each platform is intended to provide a clear basis for launching to the next, based on the premise that a certain level of PFM competence is required to enable further progress to take place. The outcome would be a GoI-owned PFM reform program that presents a detailed, prioritized, and sequenced action plan to remedy the problems afflicting the PFM system by strengthening accountability and improving transparency, within the context of a medium-to-long term timeframe.

204. **Based on the analysis of the PEIA an initial PFM Reform Program (PFMRP) of reform has been drafted** following the “platform approach”. The high-level objective of the first platform is to achieve a more credible and realistic budget. This platform might comprise the following seven key development objectives and supporting measures.

- Improving Budget Preparation – this would include improving budget comprehensiveness and integration, and enhancing budget guidance and compliance
- Improving Realism and Sustainability of the Budget – this would cover improving resource mobilization, cash and debt management, re-designing the

budget cycle and associated institutional arrangements, piloting program-based budgeting and Medium Term Expenditure Frameworks, and increasing the transparency of inter-governmental fiscal relations

- Facilitating Budget Execution – this would include improving the ability of ministry staff to understand and implement their budgets, taking steps to avoid the accumulation of payment arrears, improving the process for approving supplementary budget credits and improving the regulatory and institutional framework for public procurement,
- Improving Reporting – improving classification systems, reinvigorating the IFMIS implementation strategy, enhancing systems for recording donor aid flows, improving in-year financial reporting, piloting expenditure tracking, reviewing the reporting requirements of public corporations and improving the transparency of non-tax revenue
- Strengthening Oversight –improving the effectiveness of internal and external audit, improving legislative scrutiny and strengthening the regulatory and institutional framework for anti-corruption
- Developing PFM Capacity – introducing motivational measures within central and line ministries, initiating integration measures between the MoF and MoP and establishing global partnership arrangements for key Iraqi public organizations

- Improving Co-ordination, Monitoring and Evaluation

205. **Subsequent platforms might have the following high level objectives:**

- Better Accountability – greater focus on what is done with public money
- Improved Linkages of Policy to Budget Planning
- Integration of Accountability and Review

206. **Further consultation with GoI departments and the Government’s development partners will be needed to finalize the program.** It is envisaged that a combination of bilateral and multilateral support would provide the required assistance to the GoI to progress the PFMRP. Multilateral assistance would include an initial grant from the European Commission of around \$20 million to finance key development measures not currently being supported. A World Bank project financed by the grant is currently being developed. The project and funds would be managed by the MoF and MoP, MoF and the BSA with Bank supervision.

Implementation Arrangements

207. **Bilateral support for the PFMRP will involve existing implementation arrangements utilized by development partners.** Key implementation arrangements that are expected to be utilized are the Provincial Reconstruction Team and Local Governance Support mechanisms.

208. **While the security situation in Baghdad has improved significantly over recent months it remains critical for sustained success that creative project implementation arrangements be established for the World Bank supervised project.** It is expected that implementation arrangements will involve a combination of on-site and off-site activities. As far as possible, capacity development workshops will

take place at the Adnan Palace in the “Amber Zone” of Baghdad, as per the PEIA workshops conducted between July and November 2007. This will be supplemented by extensive use of video-conferencing facilities enabling additional input from key international consultants unwilling to work for the GoI in Baghdad. It is expected that the GoI will choose to use a greater number of local experts or members of the diaspora who have strong links within Baghdad. Overseas study tours to provide exposure to modern international practice will also be considered as appropriate.

Attachment 1

Worksheet for PFM Performance Indicators PI-1 and PI-2

Table 1 - Fiscal years for assessment

Year 1 =	2004
Year 2 =	2005
Year 3 =	2006

Table 2

functional head	Data for year = 2004 Billions ID		difference	absolute	percent	
	Original Budget	Est. Actual				
Finance	16,009	23,354	7,345	7,345	45.9%	
Health	1,421	684	(737)	737	51.9%	
Education	816	1,143	327	327	40.1%	
Public Work	309	342	33	33	10.5%	
Housing and Construction	255	143	(112)	112	43.8%	
Water Resources	218	183	(34)	34	15.8%	
Justice	208	62	(146)	146	70.3%	
Interior	187	1,177	990	990	528.3%	
Higher Education	183	301	118	118	64.7%	
NGOs	141	-	(141)	141	100.0%	
Transportation	127	116	(12)	12	9.1%	
Planning and Developmental Cooperation	70	50	(21)	21	29.4%	
Foreign Affairs	67	81	14	14	21.0%	
Agriculture	53	182	129	129	242.8%	
Social Affairs	52	39	(14)	14	25.9%	
Sciences and Technology	36	43	6	6	17.5%	
Security Affairs	35	823	788	788	2265.4%	
Youth and Sport	22	24	2	2	7.5%	
Trade	15	16	1	1	6.3%	
Culture	14	46	33	33	235.9%	
	21 (= sum of rest)	48	13	(35)	35	72.3%
total expenditure	20,286	28,821	8,534	8,534	42.1%	
composition variance	20,286	28,821		11,037	54.4%	

Table 3

Data for year =		2005				
functional head	Original Budget	Est. Actual	difference	absolute	percent	
Finance	18,015	14,771	(3,244)	3,244	18.0%	
Oil	4,581	240	(4,341)	4,341	94.8%	
Kurdish Region	3,749	3,910	160	160	4.3%	
Defence	2,000	1,649	(351)	351	17.5%	
Health	1,537	761	(776)	776	50.5%	
Education	1,268	1,407	139	139	10.9%	
Interior	1,216	1,425	209	209	17.2%	
Electricity	550	220	(330)	330	60.0%	
Housing & Construction	436	167	(269)	269	61.7%	
Higher Education and Scientific Research	360	390	31	31	8.5%	
Water Resources	353	240	(113)	113	32.0%	
Public Works	304	160	(144)	144	47.3%	
Transportation	278	71	(208)	208	74.6%	
Communications	209	9	(201)	201	95.9%	
Labour and Social Affairs	153	152	(1)	1	0.5%	
Council of Ministers	118	62	(56)	56	47.1%	
Justice	116	72	(45)	45	38.3%	
Presidency	108	70	(38)	38	35.3%	
Planning and Development Cooperation	93	12	(82)	82	87.3%	
Foreign Affairs	81	77	(4)	4	5.3%	
21 (= sum of rest)	471	591	119	119	25.3%	
total expenditure deviation	35,996	26,453	(9,543)	9,543	26.5%	
composition variance	35,996	26,453		10,859	30.2%	

Table 4

Data for year =		2006				
functional head	Original Budget	Est. Actual	difference	absolute	percent	
Finance	24,502	20,436	(4,066)	4,066	16.6%	
Defence	5,164	2,118	(3,046)	3,046	59.0%	
Oil	4,742	287	(4,455)	4,455	93.9%	
Kurdish Region	4,275	4,507	232	232	5.4%	
Interior	2,939	2,246	(693)	693	23.6%	
Electricity	1,851	420	(1,431)	1,431	77.3%	
Health	1,608	820	(788)	788	49.0%	
Education	1,588	1,529	(59)	59	3.7%	
Higher Education and Scientific Research	674	531	(144)	144	21.3%	
Public Works	620	200	(420)	420	67.7%	
Housing & Construction	396	197	(199)	199	50.3%	
Water Resources	388	213	(175)	175	45.2%	
Transportation	290	51	(239)	239	82.3%	
Communications	260	11	(249)	249	95.6%	
Labour and Social Affairs	244	74	(171)	171	69.9%	
Council of Ministers	184	104	(80)	80	43.5%	
Foreign Affairs	145	93	(52)	52	35.8%	
National Assembly	130	81	(48)	48	37.3%	
Presidency	108	99	(9)	9	8.6%	
Justice	106	83	(23)	23	21.6%	
21 (= sum of rest)	750	491	(259)	259	34.5%	
total expenditure deviation	50,963	34,590	(16,373)	16,373	32.1%	
composition variance	50,963	34,590		16,838	33.0%	

Table 5 - Results Matrix

Year	For PI-1 Total exp. Dev	Total exp. Var	For PI-2 Var in excess of
2004	42.1%	54.4%	12.3%
2005	26.5%	30.2%	3.7%
2006	32.1%	33.0%	0.9%

PI 1	No of years
	- Less than 5% deviation
	- Between 5% and 10% deviation
	- Between 10% and 15% deviation
	3 Greater than 15%
Score	D
PI 2	No of years
	2 less than 5% deviation
	1 greater than 5% deviation
	1 greater than 10% deviation
Score	C

Attachment 2: Sources of information

209. **Much of the data and information was gathered during a series of 10 workshops held in the Adnan Place, Baghdad in the second half of 2007.** These benefited from a high level of attendance and participation by a wide range of GoI officials. Other workshops in Amman, Jordan also provided valuable information. Outside the workshops information has been obtained from the Ministry of Finance, Ministry of Planning and Board of Supreme Audit as well from the IMF Stand By Arrangement reports.

