Republic of Iraq
Banking Sector Reform Project

The World Bank
Supervision Mission

July 17-20, 2010

Aide-Mémoire

I. Introduction

1. A World Bank supervision mission led by Ms. Sahar Nasr, Lead Financial Economist, and Task Team Leader (MNSFP); and comprising Mr. Jorge Araujo, Lead Economist (MNSPR); Ms. Nazaneen I. Ali, Senior Procurement Specialist (MNAPR); and Mr. Jad Mazahreh, Financial Management Specialist (MNAFM) took place in Amman, Jordan from July 17-20, 2010. Mr. Ziad Badr, Head of Mission, Iraq Office in Amman (MNCII) have participated in key meetings. The mission was supported by Hanan Al Kortany, and Amira Zaky in terms of coordination with counterparts, and mission preparatory work. This Aide Mémorie summarizes the findings and recommendations of the mission, which is subject to management review.

2. The Bank mission carried out its work in close consultation with the Central Bank of Iraq (CBI), Ministry of Finance, the Board of Supreme Audit (BSA), and the two state-owned commercial banks—Rasheed Bank and Rafidain Bank. Meetings were held with Dr. Sinan Alshabibi, CBI Governor; and Dr. Azez Jafar, Advisor to the Minister of Finance; as well as with the Iraqi Banking Reform Executive Steering Committee (ESC), chaired by Dr. Ahmad Al-Juboori, Deputy Governor of CBI; and comprising Mr. Waleed Eidy, General Manager of Supervision Department, CBI; Dr. Huda Hadi, Advisor to the Minister of Finance; and Mr. Abdulhadi Farhan, General Manager of BSA. The Bank mission also met with the senior management of the two state-owned banks; Mr. Kadhm Mohamed Nashoor, Director General, Rasheed Bank; and Mr. Mohsin Abed Hasan, Assistant Director General, Rafidain Bank, as well as Rana Jabbar, Assistant of the Deputy Governor, CBI. The mission was joined by the Project Management Unit (PMU) team, comprising; Dr. Majid Al Souri, Director; Ms. Leena Khider, Procurement Officer; and Ms. Lamees Azouz, Financial Management Officer. A list of officials met is provided in Annex I.

3. The mission also worked closely with the IMF Stand-By Arrangement (SBA) mission. The IMF held a First Review under the SBA in Amman, Jordan, during July 13-17.

II. Mission Objectives

4. The main objective of the mission was to supervise the Iraq Banking Sector Reform Project, and assess progress achieved to date focusing on the project's main components, namely: (i) institutional and operational restructuring of the two state-owned commercial banks;

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1 The IMF Board meeting for the First Review is currently scheduled for September 10, 2010.
(ii) financial restructuring of the two state-owned commercial banks; (iii) strengthening the regulatory and supervisory functions of the CBI; and (iv) project management, monitoring and evaluation. The Bank mission also discussed with the Ministry of Finance the next steps for moving forward with the Fiscal Sustainability Development Policy Loan (DPL).

5. A key objective of the Bank mission was to discuss and agree with the authorities on next steps in terms of project implementation, in the context of the extension of closing date. The mission agreed with the authorities on the actions that will be taken under the new timeline of the project to ensure effective and smooth implementation, as per the letter from the Regional Vice President Dr. Shamshad Akhtar addressed to His Excellency Dr. Sinan Al Shabibi dated July 14, 2010 approving the extension of the closing date from October 31, 2010 till June 30, 2013, in response to His Excellency's request dated June 23, 2010.

6. The mission also discussed with the Iraqi counterparts the implications of the recent June 13, 2010 attacks on CBI and the PMU, which led to the destruction of all records, including procurement and financial management records, and PMU equipment. The mission as well explored areas in which further support can be provided to CBI, such as and not limited to: (i) studying the operational needs of the PMU to resume working in an efficient business environment; and (ii) replacing the destroyed assets as well as retrieving the lost documents. Also, discussions were held on the situation of the Inter Banking Network (IIBN) that have been completely destroyed as a result of the attacks.

III. DESCRIPTION OF THE OPERATION

7. The operation comes as a response to the request by the Government of Iraq to the World Bank for supporting the implementation of Phase I of the Iraq Banking Reform Strategy—Action Plan (2008-2012). The project, which amounts to US$ 10 million, is provided through the Iraq Trust Fund (ITF) to finance the costs and activities associated with the restructuring of the banking sector in Iraq. Specifically, it would support the restructuring of the two state-owned banks and develop their activities in the financial sector—in parallel with on-going efforts to strengthen the banking sector’s regulatory and supervisory framework in line with international standards. The recipient of the grant and the implementing agency is CBI.

8. On the overall financial system in Iraq, there are currently 43 banks—seven of which are state-owned. As of April 30, 2010, total assets of the system amounted to ID 344 trillion—ID 290 trillion (84 percent) and ID 22 trillion (6 percent), belonging to Rafidain Bank and Rasheed Bank respectively. There is no deposit insurance system in Iraq.

9. Of primary importance is to build the capacity of the two largest state-owned commercial banks with their huge branch network (293 branches) to play an effective role in financial intermediation, and be able to provide the resources needed for Iraq’s growth and offer good deposit and payment systems for the business and household sector. This would in a later stage allow private banks to also contribute to the financing of Iraq’s development. Underpinning the modernization of the state-owned banks would be the strengthening of the regulatory and supervisory capacity of CBI.
10. Overall, this operation would assist Iraq in developing modern financial institutions that can operate efficiently and competitively in a market-based environment. It will thereby foster more efficient financial intermediation, resource mobilization and risk management, and increase private participation in the provision of financial services in the medium-term. Capacity building is essential to allow the Iraqi government ownership of the reconstruction and reform agenda. International experience with reconstruction in conflict-affected countries has shown that a sound and efficient financial sector is essential for economic growth and development.

IV. MISSION FINDINGS

11. Recent attacks on CBI. On June 13, 2010, series of explosions and attacks on the CBI, that left casualties and two floors at CBI got on fire. The mission discussed the implication of the explosion on the CBI and the PMU, which led to the destroy of all records, including procurement and financial management records, and PMU equipment. The Bank mission explored areas in which further support can be provided to CBI in procurement of office equipment and furniture for the PMU, to resume working in an efficient business environment, replacing the destroyed assets.

12. Good progress. Since the last supervision mission on December 2009, good progress has been made in signing consultancy contracts, issuing RFPs, and receiving proposals, however the June attack caused serious delays that affect the progress in implementation. The PMU had reallocated themselves to a temporary location but can not function efficiently because of the tight security around that alternative location. The PMU will need to reallocate again to a new location within the Rafidain Bank—HQ close to the CBI location.

13. Disbursement. The mission reviewed financial management (FM) arrangements, followed on pending issues and matters, and highlighted the current status of the FM aspects of the project. As reconciled to the Bank Client Connection, a total of US$216,483 has been disbursed as of July 19, 2010 which equals to 2.16 percent of the total Grant amount of US$10 million.

14. Considerable progress has been made over the past months in the implementation of the banking sector reform program. The Bank has been providing technical support and advisory services to the Iraqi authorities. This has led to the development of a comprehensive, action-specific Banking Reform Strategy-Action plan (2008–2012), which was done in consultations with CBI, BSA, and the senior management of the two state-owned banks. As a result, consensus was reached among all counterparts on a unified strategy, which became the binding document for banking reform in Iraq, and has allowed Iraqi authorities to meet the benchmark set forth by the IMF SBA. Good progress has been made to date towards the objectives laid out by the Government of Iraq in its comprehensive five-year Banking Reform Strategy. Despite delays in implementation and slower than anticipated disbursement due to the complex situation on the ground, the PMU has made progress in the implementation of the four components of the project.
Component I: Institutional and Operational Restructuring of the Two State-owned Commercial Banks

15. Under institutional and operational restructuring, this project provides capacity building and training to the two state-owned banks staff, covering the following components of Phase I of the Banking Reform Strategy: (i) reorganizing the organizational structure and implementing the changes; (ii) improving HR processes;\(^2\) (iii) conducting risk management, both credit and non-credit risk management; and (iv) IT infrastructure, covering all operational aspects, security system of information and management of information systems.

16. Various workshops will be held in coordination with other donors for the capacity building of the management and staff of the two-state-owned banks, along with staff from the Ministry of Finance, CBI, and BSA. These workshops will provide the participants the best practice in terms of organizational structure of commercial banks, helping them in establishing new units, such as Risk Management Units, and in identifying the required caliber. This would also entail sharing with them means for improving HR processes. Training on risk management will include support for establishment of a well-functioning, adequately managed and completely staffed risk management organization in line with international and regional best practices; changes in the organizational structure, especially the set up of a risk control department; and development of manuals for risk management.

17. Some achievements have been made in moving forward in the implementation of institutional and operational restructuring of the two state-owned commercial banks, as evident in:

- **Organizational Structure and Capacity building**: the proposals had been received and evaluated and negotiation started in April 2010 but not finalized due to discussions on reimbursement by covering hardship allowances, insurance, and security cost to the consultants staff in Baghdad. The Mission urged the negotiation committee to finalize negotiation in due time and send the initialed contract to the Bank’s for No Objection.

- **Internal Audit and Compliance**: Technical and financial proposals were received, however all proposals were damaged because of the recent attack on CBI and PMU. The PMU needs to request the short listed firms to submit their proposals and set a new closing date.

- **Risk Management**: The mission discussed the timing for launching of publishing the EOI and decided to postpone to coincide with the recommendations the organizational restructuring.

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\(^2\) This includes support for: (i) establishment of a well-functioning, adequately managed and completely staffed risk management organization in line with international and regional best practices; (ii) changes in the organizational structure, especially the set up of a risk control department; (iii) development of manuals for risk management; (iv) amendments to existing credit approval procedures on the basis of accepted best practices; (v) improved measuring and monitoring capabilities that will enable the banks to produce comprehensive and accurate reports on a bank-wide basis, including the ability to identify “single obligors” and aggregate such exposures; and (vi) training in human resource management.
- **IT Training**: EOI was advertised and RFP were sent to the short listed firms but due to the attack the closing dates were extended to August 7, 2010.

- **Training of the Branch Managers and Training of Human Resources contracts**: Technical proposals were evaluated and World Bank’s No Objection was granted but the proposals were damaged because of the attack. The PMU will request the short listed firms to re-submit the technical and financial proposals and proceed with the public opening of the financial proposals. The PMU and evaluation committee will carefully re-examine the technical and financial proposals and compare with the technical evaluation report to avoid any attempt of changing any proposal.

**Component II: Financial Restructuring of the Two State-owned Commercial Banks**

18. The second component of the operation focuses on capacity building and training in the following areas: (i) finance and accounting—restructuring the balance sheets of these two banks and developing the accounting systems; and (ii) internal audit and compliance, focusing on the process, audit framework, methodology, and effectiveness of internal audit. The project will support in organizing workshops and provide technical assistance on the best means of addressing the problem of non-performing loans (NPLs) by sharing the experience of other developing and developed countries in cleaning up the balance sheets of their state-owned banks, and will also guide the Iraq authorities in choosing the most suitable approach to the Iraqi circumstances. In addition, the project will also ensure that the new accounting systems lead to balance sheets that reflect net asset values and the banks’ financial position, through capacity building in the area of finance, accounting, internal audit and compliance.

19. The financial restructuring phase included restructuring the balance sheets by transferring the debts, public entity NPLs and losses inherited from the past regime to the Ministry of Finance within an agreed upon process after full reconciliation is maintained with the Ministry of Finance. The Ministry of Finance, in coordination with CBI have been working on addressing the problem NPLs. This process compelled the banks to sort out and reconcile assets and liability accounts, before the Government providing any new capital. The state-owned banks have verified their obligations toward some of the foreign creditors, for which a settlement by the Ministry of Finance were reached, with the assistance of a qualified international auditor.

20. However, limited action was taken until today due to various reasons, the most important of which was no one assuming the required responsibility. the Bank team had been informed that NPLs for the two state-owned banks had declined to reach ID110 billion in December 2009 (a reduction by 23 percent as of June 2007). However, during the mission, there was some uncertainty on the part of the Iraqi authorities as to the precise NPL amounts for the two banks. Again, it will be critical to obtain accurate information on the NPLs for the upcoming DPL1 supervision mission. The banks needed an instruction from the Ministry of Finance on which and how much of debt, to which creditor are to be deleted from the books. As a result the balance sheets still contain inherited debts and losses.

21. The second step of financial restructuring will be the capitalization of these two banks by the Ministry of Finance in line with the capital adequacy regulations of the CBI. However, the capitalization of Rafidain Bank should not be realized unless bankruptcy court case against its
London subsidiary is concluded to the satisfaction of Iraq. Moreover, the recapitalization of Rafidain Bank and Rasheed Bank and the restructuring of their balance sheets should go hand in hand with the operational and institutional restructuring, especially establishing an appropriate governance structure and strengthening risk management and control functions.

22. The financial restructuring of Rasheed Bank and Rafidain Bank would be accelerated through the establishment of a Financial Restructuring Reconciliation Committee, which would be chaired by a representative from the Ministry of Finance (as the owner of state-owned banks), and comprising management of the two state-owned banks. CBI and BSA agreed to be observers, while Ernst and Young (E&Y) would be active members to guide on audit issues. This Committee would work under Restructuring Oversight Committee (ROC), and would focus on addressing the problem of external debt rather than NPLs of SOEs, which is quite negligible as opposed to the former. While there was clarity about the mandate of this Committee, a decision on its structure and management will be taken at a later date. A proposed timeline for the Committee’s activities is in Annex VI.

23. Some achievements have been made in moving forward in the implementation of the financial restructuring of the two state-owned commercial banks, as evident in:

- **Financial Restructuring**: Technical and Financial proposals received but the PMU will need to ask the short listed firms in setting a new closing date and resubmitting their proposals due to the mentioned damages on CBI and PMU.

- **Training for Risk Management, Financial Restructuring, and Internal Audit and Compliance**: The RFP was issued to the short listed firms and the closing date for submission was extended to August 4, 2010.

**Component III: Strengthening the Regulatory and Supervisory Functions of the CBI**

24. The project provides capacity building to CBI to enhance its supervisory and regulatory authorities. Under this component, support would provide in reviewing the existing banking supervision process, assessing the effectiveness of its supervisory apparatus to the adherence to international codes and standards, and preparing a detailed action plan to address any deficient, gaps and needs in coordination with the IMF. Capacity building and training of the staff of the supervision department at CBI would include setting up the underpinnings of a strengthened regulatory and supervisory framework, focusing on on-site and off-site processes. CBI needs to implement the corrective actions required to close the gap between existing practices at CBI and international accepted best practices.

25. CBI is currently working on its regulatory and supervisory authority. Developments at that front include:

- **Strengthening the regulatory and supervision functions of CBI**: The contract with the selected consultant was signed on April 2010 and the consultant commenced his task at CBI—Baghdad on May 30, 2010.
Training of Banking Supervision of CBI: three institutions were short listed but only the Central bank of Egypt submitted their proposals before the closing date. The evaluation committee studied the sole proposals and found it satisfactory, WB’s no objections were granted on the technical proposal and later on the negotiated contract. The PMU needs to get the needed approval and sign the contract.

Component IV: Project Management, Monitoring and Evaluation

26. This component of the project covers all costs related to the management, monitoring and evaluation of the project. It includes the costs associated with the establishment of PMU, along with salaries of PMU staff, that would include: (i) maintenance of office equipment; (ii) office supplies, utilities, and office administration costs, including translation, printing and advertising; (iii) communication costs; (iv) costs associated with the production of bidding documents; and (v) commercial bank charges. Costs will also include: (i) transportation and travel including per diem allowance for PMU staff in travel status to attend supervision missions; any other project implementation related expenses as agreed by CBI and the Bank.

27. Due to the recent attacks in June 13, 2010 on the CBI, most of the office equipment and construction works at CBI and the PMU were destroyed. Hence, some funding will be allocated to support the CBI in restoring its business operations as quickly as possible. This funding would be drawn from funds initially allocated to Component (iv) of the Emergency Banking Sector Reform Project, which covers all costs related to the management, monitoring and evaluation of the project.

28. The World Bank also plans rehabilitation work in CBI for IIBN (the inter-banking network). IIBN is used to run the payment system and RTGS in CBI. IIBN was built under the World Bank’s Emergency Private Sector Development project. The system was commissioned in 2009. Due to the recent attack on CBI, the IIBN site at CBI has been destroyed, but IIBN is still operating. CBI is one of the two main sites of IIBN and needs to be rebuilt.

29. In order to achieve the project development objective and ensure full implementation of the project’s key components, it was crucial to extend the closing date of the project. There are some components that would require more than a year to attain adequate implementation, for which the Bank cannot provide its no objection to some contracts since they will not be fulfilled by the original closing date (October 31, 2010), which was set prior to the formal extension of the Iraq Trust Fund (ITF). Furthermore, capacity-building activities such as technical training are behind schedule and the lack of interest by international consulting firms and individuals to work in Iraq remains a challenge. However, the signing of a number of contracts during the coming period is anticipated.

30. An Action Plan was agreed upon with the Recipient and the team is comfortable that the action plan is feasible and will enable a successful achievement of the project development objectives (Annex III). There are no overdue audit reports and Interim Un–audited Financial Reports (IFRs) have been timely submitted to the World Bank. In that context, the Regional Vice President Dr. Shamshad Akhtar has approved the extension of the closing date from October 31, 2010 till June 30, 2013, in response to His Excellency CBI Governor’s request dated June 23, 2010.
V. Bank Restructuring Discussions under the International Monetary Fund (IMF) Stand-By Arrangement (SBA) Mission.

31. The IMF held a First Review\(^3\) under the SBA in Amman, Jordan, during July 13-17, which was led by Ron van Rooden, IMF Mission Chief to Iraq; and joined by a financial expert.\(^4\) The restructuring of the Rasheed Bank and Rafidain Bank were a central part of the IMF discussion with the Iraqi authorities. One of the SBA’s structural benchmarks – originally due by June 30, 2010—is the completion of the restructuring of the balancing sheets of Rasheed Bank and Rafidain Bank, a roadmap for accelerating the operational and restructuring process for the state-owned banks was discussed with the Iraqi authorities.

32. Some of the key outcomes of these are summarized below:

- The IMF team and the Iraqi authorities discussed the creation of a Bank Restructuring Committee, comprising technical staff from the two banks, the CBI, the Ministry of Finance, BSA and E&Y (see Annex VI). The Committee would be focused on financial restructuring only and mandated to: (i) conduct the reconciliation between the debt items in the Ministry of Finance’s settlement agreements and the books of the two state-owned banks; (ii) identify the debt items in the books of the banks that differ in amount with respect to the same item as shown in the settlement agreements; and (iii) proposing a course of action to the Steering Committee or the ROC for the unsettled debts.
- The restructuring of the balance sheets of the two banks should be completed by June 2011.
- The discussions also emphasized that recapitalization of Rasheed Bank and Rafidain Bank should be preceded by: (i) the completion of the restructuring of the balance sheets of the two banks; (ii) resolution of the ongoing bankruptcy court case against Rafidain’s London branch; and (iii) adequate progress in the operational restructuring of the two banks.

VI. Procurement Arrangements

33. Recent attacks on CBI. On June 13, 2010, series of explosions and attacks on the CBI, that left casualties and two floors at CBI got on fire. The mission discussed the implication of the explosion on the CBI and the PMU, which led to the destroy of all records, including procurement and financial management records, and PMU equipment. The Bank mission explored areas in which further support can be provided to CBI in procurement of office equipment and furniture for the PMU, to resume working in an efficient business environment, replacing the destroyed assets.

34. Good progress. Since the last supervision mission on December 2009, good progress has been made in signing consultancy contracts, issuing RFPs, and receiving proposals, however the June attack caused serious delays that affect the progress in implementation. The PMU had reallocated themselves to a temporary location but can not function efficiently because of the tight security around that alternative location. The PMU will need to reallocate again to a new location within the Rafidain Bank—HQ close to the CBI location.

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\(^3\) The IMF Board meeting for the First Review is currently scheduled for September 10, 2010.

\(^4\) Mr. R. Engin Akçakoca, from KAB Consulting.
35. **High consultants’ fee in Iraq.** Work on Iraq has a special flavor where international consultants can not travel to Baghdad unless adequate security arrangements made for them. Under Bank’s Procurement Guidelines, such consultants are selected by the Client (not by the Bank) based on their qualifications. The Guidelines do not provide rules with regard to consultant compensation; fees are negotiated between the Client and the consultant. The Bank does not play a role in setting the fees. In addition, the implementing agencies have difficulties evaluating CVs, establishing the correct level of expertise, and assessing the appropriateness of the fees and expenses requested by consultants. The main factor includes high demand (including from government, UN, and bilateral donors) and the limited supply of consultants with appropriate skills who are willing to work in those circumstances.

36. **Delay in signing contracts.** The mission advised the Iraqi delegation to streamline the needed approvals for recommendation to award to avoid any delay that take place after getting the Bank’s no objection on the negotiated contracts.

37. **Progress Status.** The mission discussed the status of each activity per the recent updated Procurement Plan and progress made at different stages that can be briefed as follows:

**VII. FINANCIAL MANAGEMENT (FM) ARRANGEMENTS**

38. The mission reviewed EBSRP implemented FM arrangements, followed on pending issues and matters, and highlighted the current status of the FM aspects of the project.

39. **Funds Flow and Disbursement.** As reconciled to the Bank Client Connection, a total of US$216,483 has been disbursed as of July 19, 2010 which equals to 2.16 percent of the total Grant amount of US$10 Million. The total net commitments (commitment less disbursement) are US$ 213,500. The Project is disbursing using direct payment and reimbursement methods. To complement that, the CBI provided the Project with an advance payment of US$80,000. The advance is mainly used to pre-finance the PMU’s operating costs and contracts bellow US$25,000. Subject to the presentation of full supporting documents to the World Bank, the Project’s accounts are then reimbursed.

40. Below is a summary of Project Financial Status as of July 19, 2010.

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<td><strong>216,483</strong></td>
<td><strong>213,500</strong></td>
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41. **Destruction of assets and World Bank support.** The recent unfortunate attack on CBI has resulted in the destruction of all PMU’s assets except three laptops that were in the possession of
staff who were outside CBI at the time of the attack. The destroyed assets include office furniture, computers, printers, scanners, network, and all other assets maintained at the PMU. The total book value of destroyed assets that were financed by the Grant is US$15,915. The Fiduciary Monitoring Agent (FMA) has visited CBI and confirmed the destruction of all PMU’s assets. In this respect, it has been agreed that all destroyed assets will be written off from the records of the PMU and the Grant will finance the cost of purchasing new assets.

42. **Loss of documents and World Bank support.** Due to the unfortunate attack on CBI, all FM related documents have been totally burned out and destroyed, including the accounting records, financial reports, assets register, all copies of withdrawal applications with the supporting documentation, bank statements etc. As part of the World Bank support in retrieving the destroyed documents, the World Bank FMS, in collaboration with the Loan Department, has provided the PMU with copies (electronic and hard) of all withdrawal applications as well as the attached supporting documents (invoices, contracts, summary sheets, bank statements, etc). The copies provided by the World Bank represent the majority of the lost documents. However, the mission has requested the Financial Officer to go through the copies provided by the World Bank and identify if there are any remaining missing documents. The mission informed the PMU that the World Bank will provide all the necessary support to retrieve any missing documents and will coordination with all related stakeholders for this purpose.

43. **Data protection measures.** The recent unfortunate attack on CBI has resulted in significant losses of Project’s data. In order to mitigate the risk of losing the Project’s data again in the future, specific measures should be implemented, such as performing regular backup of Project’s data. The PMU is advised to perform regular backup, preferably on weekly basis, for the Project’s data using external hard drives with very high capacity and kept offsite. The mission as well urged the PMU to maintain electronic copies of all the Project’s hard documents. In addition, the mission urged the PMU to maintain the documents in fire proof cabinets. Those cabinets can be either provided by CBI or being purchased from the local market.

44. **External auditing.** The mission agreed with the PMU to re-launch the auditor’s selection process based on the following facts:

- The Project has been extended to additional three years, up to June 30, 2013, thus the audit contract and Terms of Reference (TOR) should be revised to reflect the auditing services as well as reporting obligations for the additional three years.
- All documents pertaining to the previous selection process has been completely destroyed by the unfortunate attack on the CBI.
- A temporary audit waiver (combination of audit periods) has been granted by the World Bank to the Project, by which the first audit report is now due by June 30, 2011 covering the period from date of effectiveness (April 17, 2009) up to December 31, 2010.
- The General Secretariat Council of Ministers new instructions dated June 1, 2010 prohibiting contracting with one of the shortlisted companies.

45. **Accounting system and reporting.** The PMU has been timely submitting the interim un–audited Financial reports (IFRs) to the World Bank. They included a statement of sources and uses of funds per category and per components, and a Project Commitments Sheet. The Financial Officer uses spreadsheet application to capture the financial transactions and generate the IFRs.
The next IFRs will cover the quarter ended June 30, 2010 will be due by July 30, 2010. However, the mission discussed with the Financial Officer of the possibility of submitting the next IFRs by the due date as the recent attack destroyed most of FM documents. The Financial Officer informed the mission that the copies of FM documents provided by the World Bank were significantly useful and she as well possesses the other necessary data to submit the next IFRs by the due date.

46. **Budgeting.** The PMU has been timely submitting the quarterly disbursement plan based on the updated procurement plan and implementation schedules. The mission agreed with the PMU that the next disbursement plan, based on the last updated procurement plan and implementation schedule, will be submitted to the Bank by no later than July 30, 2010. As the closing date of the Project has been extended for additional three years (up to June 30, 2013), the mission reminded the PMU that the next disbursement plan should reflect the disbursements’ projections based on the new closing date.

47. **Staffing.** The PMU’s financial management and accounting functions are covered by a full time Financial Officer, fully financed by the grant. The FM related issues have been discussed with the Financial Officer as well as the PMU Director.

48. **Post—review withdrawal applications.** The FMA reports covering the period from October 1, 2009 up to March 31, 2010 documents the review, on a sample basis, of withdrawal applications for direct payments and reimbursements submitted during the same period. The FMA review revealed that the original supporting documents were examined and that the expenditures were confirmed to be eligible and in compliance with grant agreement.

49. **Internal controls.** The PMU has satisfactory internal controls in place for the Project, including regular reconciliation of bank accounts, proper segregation of duties, regular reconciliation of disbursement summaries of the World Bank with project accounting records, and access to the Client Connection system. All financial management and accounting procedures are documented in the FM Manual as part of the Project Implementation Manual (PIM). The mission advised the PMU Financial Officer to revisit the FM manual, on regular basis, to update the chapter, if needed.

**VIII. NEXT STEPS**

50. The following next steps have been agreed on with the Iraqi authorities:

- Implementation of the revised and agreed upon Action Plan, according to the new timeline of the project.
- Recollection of destroyed and lost PMU documents.
- The PMU will re-launch the auditor’s selection process immediately.
- The PMU will submit to the Bank the Disbursement plan and the IFRs for Q2 2010 by July 30, 2010.
- A supervision mission would be scheduled for late November 2010, to assess progress achieved under the new timeline of the project.
▪ The Governor also stressed the importance of finalizing the hiring process, under the Iraq Emergency Banking Sector Reform Project, for an Advisor for CBI.

▪ All settled debts should be deleted from the balance sheets of Rafidain Bank and Rasheed Bank. In that regard, a “Bank Reconciliation Committee” should be established, chaired by the Ministry of Finance as the owner of the two state-owned commercial banks, with the participation of technical level staff from Rasheed Bank, Rafidian Bank, and E&Y, with CBI and BSA as observers, to be responsible for:

(i) determining the reconciling debt items in the list of the settlement agreements of the Ministry of Finance and the books of the banks;

(ii) determining the debt items in the books of the banks that are more than the amount of the same debt item indicated in the settlement agreements;

(iii) determining the debt items in the books of the banks which are less than the amount of the same debt item indicated in the settlement agreements;

(iv) deciding on course of action for Unsettled Debts; and

(v) obtaining the approval of the Executive Steering Committee or the ROC for any accounting entries in the banks or written information to be provided to other authorities including the Ministry of Finance. The decisions of the Bank Reconciliation Committee, the Executive Steering Committee, or ROC should be made unanimously.5

5 The items in the Settlement Lists are considered to match the items in the list of E&Y which will also be submitted to the banks by the Ministry of Finance or by E&Y at the instruction of Ministry of Finance.
ANNEX I
Officials Met by the Bank Mission

Central Bank of Iraq
Dr. Sinan Alshabibi, Governor
Mr. Ahmed Salman Al-Juboori, Deputy Governor
Mr. Waleed Aidi Abdulnabi, Director General of the Supervision Department
Ms. Rana Jabbar Ali, Assistant of the Deputy Governor

Ministry of Finance
Dr. Azez Jafar, Advisor to the Minister of Finance
Dr. Huda Hadi, Banking Expert in Ministry of Finance responsible for state-owned banks

Board of Supreme Audit (BSA)
Mr. Abdulhadi Farhan, General Manager

Rafidain Bank
Mr. Mohsin Abed Hasan, Assistant of General Director

Rasheed Bank
Mr. Kadhim Mohammed Nashoor, Director General

Project Management Unit (PMU)
Dr. Majid Al-Soori, Director
Ms. Leena Khider, Procurement Officer
Ms. Lamees Azouz, Financial Management Officer
ANNEX II

Restructuring of the internal audit and compliance units at Al Rasheed Bank and Al Rafidain Bank, state-owned commercial banks

1. The PMU has issued an Expression of Interest (EOI), in compliance with Bank’s procurement guidelines, with regard to restructuring of the internal audit and compliance units at Al Rasheed Bank and Al Rafidain Bank, state-owned commercial banks.

2. On November 23, 2009, EOI has been advertised in United Nations Development Business (UNDB) and DG Market websites. Four consulting firms expressed their interest; Huron Consulting Group, Price Water House Coopers, International Business and Technical Consultants, Inc., and Francis Domnic Noronha. Subsequently, an Evaluation Committee was established and conducted a primary evaluation of the received EOIs.

3. The Committee shortlisted three firms and the PMU issued Requests for Proposal (RFP) for the shortlisted firms. On May 10, 2010, the PMU received the technical and financial proposals from the three shortlisted firms. The Committee held two sessions in order to evaluate the received technical proposals. Due to the unfortunate attack that resulted in burning out all the PMU’s assets and documents; the process has been postponed until the PMU retrieve the lost documents and re-establish the new offices. In this respect, the PMU will be requesting the shortlisted firms to re-submit their technical and financial proposals.
ANNEX III
Action Plan for EBSRP prepared by PMU

The details of actions to be completed under each component of the project during the extension period.

Due to the security situation, after the attempt of attacking the Central Bank of Iraq in Shorja which took place on June 13, 2010, and led to burning all the furniture and documents, for each of the PMU office, CBI, and the Two State Owned Commercial Banks [Rafidain & Rasheed], therefore the activities that related of this grant will be stopped for 2 months. And one month is required for supplying of the new documents by the short listed institutes instead of the burned doc.

Component I: Institutional and Operational Restructuring of the two State owned Commercial Banks

<table>
<thead>
<tr>
<th>SI #</th>
<th>Consulting Services</th>
<th>Implementation Period</th>
</tr>
</thead>
</table>
| 1    | Consulting services for the Organization Structure & Capacity Building of the Two State-Owned Commercial Banks [Rafidain & Rasheed] | 1. Implementation of which to be started on September 27, 2010 and ended on March 26, 2011.  
2. Two years for conducting the new approved Organization Structure to be started on March 26, 2011 and ended on March 26, 2013.  
3. Three months for monitoring & following by the PMU to be started on March 26, 2013 and ended on June 30, 2013. |
| 2    | Consulting services for the Restructuring of the Internal Audit and Compliance unit(s) of the Two State-Owned Commercial Banks [Rafidain & Rasheed] | 1. Implementation of which to be started on December 20, 2010 and ended on June 18, 2011.  
2. One and half year for conducting the new approved Organization Structure to be started on June 18, 2011 and ended on December 18, 2012.  
3. Six months for monitoring & following up by the PMU to be started on December 18, 2012 and ended on June 30, 2013. |

Training Services

<table>
<thead>
<tr>
<th>SI #</th>
<th>Training services for Computer Skills Development (professional programs) for the Two State-Owned Commercial Banks [Rafidain &amp; Rasheed]</th>
<th>Implementation Period</th>
</tr>
</thead>
</table>
| 1    | Implementation of which to be started on December 12, 2010 and ended on April 25, 2012.  
2. One year for workshops by trainees for training other employees in the Two Banks to be started on April 25, 2012 and ended on April 25, 2013.  
3. Two months for monitoring & following up by the PMU to be started on April 25, 2013 and ended on June 30, 2013. |
<table>
<thead>
<tr>
<th>SI #</th>
<th>Action</th>
<th>Implementation Period</th>
</tr>
</thead>
</table>
| 2    | Training services for Branch Managers of the Two State - Owned Commercial Banks [Rafidain & Rasheed] | 1. Implementation of which to be started on October 25, 2010 and ended on June 12, 2012.  
2. Nine months for workshops by trainees for training other employees in the Two Banks to be started on June 12, 2012 and ended on March 12, 2013.  
3. Three months for monitoring & following up by the PMU to be started on March 12, 2013 and ended on June 30, 2013. |
| 3    | Training services for Human Resources of the Two State - Owned Commercial Banks [Rafidain & Rasheed] | 1. Implementation of which to be started on October 28, 2010 and ended on December 27, 2010.  
2. Two year for workshops by trainees for training other employees in the Two Banks to be started on December 27, 2010 and ended on December 27, 2012.  
3. Three months for monitoring & following up by the PMU to be started on December 27, 2012 and ended on March 27, 2013. |

**Component II: Financial Restructuring of the Two State-owned Commercial Banks.**

<table>
<thead>
<tr>
<th>SI #</th>
<th>Action</th>
<th>Deadline</th>
</tr>
</thead>
</table>
|      | Consulting Services                                                    | 1. Implementation of which to be started on December 20, 2010 and ended on June 18, 2011.  
2. One and half year for conducting the new approved Organization Structure to be started on June 18, 2011 and ended on December 18, 2012.  
3. Six months for monitoring following up by the PMU to be started on December 18, 2012 and ended on June 30, 2013. |
|      | Training Services                                                      | 1. Implementation of which to be started on January 7, 2011 and ended on February 11, 2012.  
2. One year for workshops by trainees for training other employees in the Two Banks to be started on February 11, 2012 and ended on February 11, 2013.  
3. Three months for monitoring & following up by the PMU to be started on February 11, 2013 and ended on May 11, 2013. |
**Component III: Strengthening the Regulatory and Supervisory Functions of CBI.**

<table>
<thead>
<tr>
<th>SI #</th>
<th>Action</th>
<th>Deadline</th>
</tr>
</thead>
</table>
| 1    | Consulting services for the Strengthening the Regulatory and Supervisory Functions of CBI | 1. Implementation of which to be started on May 30, 2010 and ended on January 25, 2011.  
2. Two years for conducting the new approved Organization Structure to be started on January 25, 2011 and ended on January 25, 2013.  
3. Five months for monitoring following up by the PMU to be started on January 25, 2013 and ended on June 30, 2013. |

<table>
<thead>
<tr>
<th></th>
<th>Training Services</th>
<th></th>
</tr>
</thead>
</table>
| 1    | Training services for Strengthening the Regulatory and Supervisory Functions of the Central Bank of Iraq (CBI) | 1. Implementation of which to be started on October 29, 2010 and ended on March 12, 2012.  
2. One year for monitoring & following up by the PMU to be started on March 12, 2012 and ended on March 12, 2013. |

**Component IV: The establishment of PMU.**

The contract of the PMU staff and External Auditor will be extension with the Grant Extension to be ended on June 30, 2013.
**ANNEX IV**

**Results Framework and Monitoring**

<table>
<thead>
<tr>
<th>PDO</th>
<th>OUTCOME INDICATOR</th>
<th>USE OF OUTCOME INFORMATION</th>
</tr>
</thead>
</table>
| The Project Development Objective is to strengthen the supervisory framework for financial intermediation and build capacity of financial institutions to support implementation of Phase I of the Iraq Banking Reform Strategy. | - New organizational structures for the two state-owned banks are adopted.  
- Number of staff trained in each bank would reach at least 100 staff member.  
- Compliance supervisory and regulatory framework (Basle Code Principles) | - Monitor progress on overall banking sector reform, with particular reference to planning next phase, whether through Bank, other donor, or internal Government resources  
- Number of staff trained in each bank would reach at least 200 staff member (tellers, managers, credit officers, etc.) |

<table>
<thead>
<tr>
<th>INTERMEDIATE OUTCOME</th>
<th>INTERMEDIATE OUTCOME INDICATOR</th>
<th>USE OF RESULTS MONITORING</th>
</tr>
</thead>
</table>
| **Component 1**: Institutional and Operational Restructuring of the Two State-owned Commercial Banks | - Improvement in functioning of the two state-owned commercial banks, evident in the increase in loan-to-GDP ratios from 4% in June 2006 to 6% in October 2010. | - Strengthened institutional and operational framework for the two state-owned banks.  
- Capacity building with staff trained for using new computers for making loans and taking deposits.  
- Improved financial intermediation evident in the rise in loan-to-GDP ratios. |
| **Component 2**: Financial Restructuring of the Two State-owned Commercial Banks | - Build-up in provision levels at the two state-owned commercial banks for new loans, reflected in the reserves-to-NPLs ratios, rising from 10% in June 2006 to 20% in October 2010. | - Improved portfolio quality of the two state-owned banks  
- Reserve-to-NPLs on new loans  
- Strengthened Capital Adequacy—Capital adequacy ratio improves as provided by government. |
| **Component 3**: Strengthening the Regulatory and Supervisory Functions of Central Bank of Iraq | - Capital adequacy ratio in line with prudential regulations, reaching up to 4% by October 2010. | - Adherence to international codes and standards regarding capital requirements (Basle Core Principles). |
| **Component 4**: Project Management, Monitoring and Evaluation | - Recruitment of qualified staff capable of effectively managing the project.  
- Capacity building granted to the Executive Steering Committee, supporting the reform program.  
- Efficient and smooth execution of the project.  
- Training program fully in place. | - Compliance with Bank’s rules and guidelines in terms of procurement procedures, and FM requirements.  
- Adequate monitoring of project.  
- Progress in implementation of project components. |

*Due to the emergency nature of the project, the results framework and the monitoring table will be revised to include more details during supervision.*
### ANNEX V

**Monitoring Indicators, Baseline, and Expected Outcomes**

<table>
<thead>
<tr>
<th>Results indicators</th>
<th>Baseline (June 2006)</th>
<th>YR1</th>
<th>YR2</th>
<th>YR3</th>
<th>YR4</th>
<th>Frequency and Reports</th>
<th>Data Collection Instrument</th>
<th>Responsibility for Data Collection</th>
</tr>
</thead>
<tbody>
<tr>
<td>PDO</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Development of new organizational structures for the two state-owned banks</td>
<td>None</td>
<td>Plans for development of new organizational structures completed</td>
<td>New organizational structures approved and adopted by October 2010</td>
<td>organizational structures adopted</td>
<td>organizational structures adopted</td>
<td>Annually</td>
<td>CBI Annual Report</td>
<td>CBI</td>
</tr>
<tr>
<td>Number of staff trained to do bank operation <em>(both banks)</em></td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>150</td>
<td>200</td>
<td>Semi-annually</td>
<td>PMU</td>
<td>PMU</td>
</tr>
<tr>
<td>State-own commercial bank’s improved their capital adequacy ratio <em>(reserves-to-NPLs ratios)</em></td>
<td>Reserves-to-NPLs ratios reaching 10%</td>
<td>Reserves-to-NPLs ratios reaching 15%</td>
<td>Reserves-to-NPLs ratios reaching 20%</td>
<td></td>
<td></td>
<td>Annually</td>
<td>Financial statements of the two state-owned banks <em>(Rasheed Bank and Rafidain Bank)</em></td>
<td>CBI</td>
</tr>
<tr>
<td>Components</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan-to-GDP ratio <em>(banking sector)</em></td>
<td>4%</td>
<td>4.9%</td>
<td>5%</td>
<td>5.5%</td>
<td>6.2%</td>
<td>Annually</td>
<td>CBI reports</td>
<td>CBI</td>
</tr>
<tr>
<td>Reserves-to-NPLs ratios <em>(both banks)</em></td>
<td>10%</td>
<td>15%</td>
<td>20%</td>
<td>25%</td>
<td>30%</td>
<td>Annually</td>
<td>CBI reports</td>
<td>CBI</td>
</tr>
<tr>
<td>Capital adequacy ratio <em>(both banks)</em></td>
<td>0</td>
<td>2%</td>
<td>2.5%</td>
<td>3%</td>
<td>4%</td>
<td>Annually</td>
<td>CBI reports</td>
<td>CBI</td>
</tr>
<tr>
<td>Number of qualifies staff in PMU</td>
<td>0</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>Semi-annually</td>
<td>PMU database</td>
<td>PMU</td>
</tr>
<tr>
<td>Timely disbursement of grant</td>
<td>0</td>
<td>1.7</td>
<td>4.6</td>
<td>2.5</td>
<td>1.2</td>
<td>Semi-annually</td>
<td>PMU database</td>
<td>PMU</td>
</tr>
</tbody>
</table>
ANNEX VI
Proposed Timeline for Actions Related to Bank Reconciliation Committee
for Rasheed Bank and Rafidain Bank

<table>
<thead>
<tr>
<th>ACTION</th>
<th>BY WHOM</th>
<th>BY WHEN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Officially establish Bank Reconciliation Unit/Committee (BRU/C) through MoF decree.</td>
<td>H.E. the Minister of Finance</td>
<td>September 15, 2010</td>
</tr>
<tr>
<td>The BRU/C should have the participation of technical level staff from the two banks, CBI, MoF, Ernst &amp; Young (E&amp;Y) and Board of Supreme Audit (BSA) (as observer).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conduct the reconciliation between the debt items in the MoF’s settlement agreements and the books of the two state-owned banks.</td>
<td>BRC</td>
<td>December 15, 2010</td>
</tr>
<tr>
<td>Identify the debt items in the books of the banks that differ in amount with respect to the same item as shown in the settlement agreements.</td>
<td>BRC</td>
<td>December 15, 2010</td>
</tr>
<tr>
<td>Propose an action plan to the ROC for the unsettled debts of the two banks.</td>
<td>BRC</td>
<td>January 17, 2011</td>
</tr>
<tr>
<td>Approve action plan for the unsettled debts of the two banks.</td>
<td>ROC</td>
<td>January 30, 2011</td>
</tr>
<tr>
<td>Implement action plan for the unsettled debts of the two banks.</td>
<td>MOF, Rasheed Bank, Rafidain Bank, BRC, ROC</td>
<td>January 30 – June 30, 2011</td>
</tr>
<tr>
<td>Complete restructuring of the balance sheets of Rasheed and Rafidain Banks.</td>
<td>MOF, Rasheed Bank, Rafidain Bank, BRC, ROC</td>
<td>June 30, 2011</td>
</tr>
</tbody>
</table>