

SAUDI ARABIAN OIL COMPANY (Saudi Aramco) GENERAL INSTRUCTION MANUAL ISSUING ORG. INTERNAL AUDITING SUBJECT: AUDIT COMMUNICATION/REPORTING PROCEDURES	G.I. NUMBER 289.000 Approved	
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CONTENT:

This instruction states the procedure for:

- Communicating audit observations and recommendations
- Soliciting responses from audited organizations
- Preparing and distributing audit reports and reviewing field memorandum
- Following-up on the implementation of audit recommendations

The major areas of discussion are:

- 1 Communicating Internal Audit Observations and Recommendations
- 2 Response to Field Memorandum
- 3 Repeat Recommendations
- 4 Draft Report Preparation
- 5 Report Format
- 6 Closing Meeting
- 7 Final Report Preparation and Distribution
- 8 High Spot Reviews
- 9 Special Audits
- 10 Development Reviews
- 11 Summary Reports to Corporate Management and the Audit Committee of the Board of Directors
- 12 Follow-up on Management Responses to Internal Audit Observations and Recommendations
- 13 Follow-up on Management Responses to External Audit Reports.

1.0 COMMUNICATING INTERNAL AUDIT OBSERVATIONS AND RECOMMENDATIONS

1.1 Internal Audit observations and recommendations are communicated by the following means:

- 1.1.1 Oral communications are used where exceptions are infrequent and of minor significance.
- 1.1.2 Field memorandum will be prepared by the auditors during the course of the audit to communicate preliminary audit observations and recommendations. The purpose of a field memorandum is to bring an audit observation to the attention of the client on a current basis and to solicit responses from the client. They will be the basis for the final audit report. The Audit Manager has the responsibility to review field memorandum prior to presentation to the client Management. Field memorandum will be addressed to the client and they will highlight the significant observations and recommendations.
- 1.1.3 The summary letter of the audit report addressed to the client's immediate supervisor (not lower than a Department head) will contain a summary of the significant audit recommendations and will be distributed along with the audit report. The audit report is a detailed report of the audit observations, recommendations and client responses normally

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prepared from the field memorandum.

- 1.2 With the rare exception of confidential audits, all audit observations and recommendations will be discussed and reviewed with the client prior to the audit report being finalized.

2.0 RESPONSE TO FIELD MEMORANDUM

- 2.1 The client's responses will be solicited for each field memorandum prepared by the auditor during the progress of an audit.
- 2.2 A response should cover (as applicable):
- action taken, planned, or deferred for further study;
 - alternatives being considered; and/or
 - reasons for rejecting the recommendation.
- 2.3 The response should be written and signed by the department head on the field memorandum or attached to the field memorandum.
- 2.4 Response to field memorandum must be made within seven (7) business days and returned to the auditor. If the response is not provided within the seven days, the Audit Manager will conduct follow up with the client Department Manager. Failure to provide an appropriate response may result in an "Auditor's Note" (see 2.5).
- 2.4.1 If the observation requires the response of an organization other than the client and the client's operation is affected by the observation, the auditor will recommend that the client request the outside organization to take corrective action. The client's response to such recommendations will be included in the audit report.
- 2.4.2 In the instance where the client's operation is not affected by the audit observation, the auditor will make the recommendation by separate letter to the proper organization and request a response within seven (7) business days. The observation may be included in the audit report, clearly identifying the responsible organization, or it may be handled as a separate memorandum or report, as deemed appropriate.
- 2.5 Occasionally, at the discretion of the Audit Manager, an "Auditor's Note" will be included in the published audit report. Normally this will occur when it is necessary to comment on the client's response to a recommendation.

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3.0 REPEAT RECOMMENDATIONS

- 3.1 A repeat recommendation is a previous audit recommendation that was reported by a client to Accounting Policy, Methods & Systems Department (APM&SD) of the Controller Organization, as implemented. However, a subsequent audit/high spot review determined that it was not adequately implemented. The Board Audit Committee (BAC) and Corporate Management have urged that recommendations should be promptly implemented and regard repeat recommendations as an unacceptable practice. Repeat recommendations are reported to the BAC.
- 3.2 At the discretion of the Audit Managers, significant repeat recommendation should be included in the summary letter (see 5.1 for report format). If a repeat recommendation is included in the summary letter, the client's business line head will be copied.

4.0 DRAFT REPORT PREPARATION

- 4.1 At the conclusion of the audit, the In-charge Auditor will prepare a draft audit report which incorporates the summary of the client's responses to the previously discussed field memorandum.
- 4.2 The draft report (stamped "DRAFT") will be reviewed by Internal Auditing Management prior to being transmitted to the client for concurrence.

5.0 REPORT FORMAT

- 5.1 The audit report generally will include four sections - Summary of Audit Report, Table of Contents, Background, and Audit Observations, Recommendations and Management Responses.
- 5.1.1 Summary Letter - Audit reports are written primarily for the benefit of client personnel and for the communication of audit observations to Management. To meet this responsibility, and yet minimize the demand on management time, the audit scope, objectives, and the significant recommendations are highlighted in the Summary of Audit Report. For easy reference, each observation discussed in this section will be indexed to the audit observations and recommendations in the audit report.
- 5.1.2 Table of Contents - The table of contents identifies each observation presented in the audit report. The table of contents will be prepared whenever four items or more are reported.
- 5.1.3 Background - The purpose of the background section is to introduce the operation or organization audited. Emphasis should be on information pertinent to the risks being addressed by the Audit. Such items as size, operating budget and manpower, current activity, and recent important developments may be highlighted in this section.

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- 5.1.4 Audit Observations, Recommendations and Management responses - Audit observations will usually be listed in order of importance within major subdivisions of the audit. Each observation will consist of three parts; observation, recommendation, and Management response. The Management response will be a summary of the client's action plan taken to implement the recommendation(s) or reasons for rejecting audit observation(s) and/or recommendation(s).

6.0 CLOSING MEETING

- 6.1 At the time the draft report is presented, the In-charge Auditor or Audit Manager will discuss the need for a closing meeting with the client.

- 6.1.1 The purpose of a closing meeting is to give the client the opportunity to:

- Correct errors or misstatements of fact,
- Discuss items felt to be inappropriate,
- Indicate previously unrecognized mitigating factors,
- Provide information regarding changes that may have occurred since preparation of the draft report.
- Provide a further response to the audit observation(s).
- Discuss any observation(s) and recommendation(s) rejected by the client or found to be a repeat; and/or
- Discuss other issues/observations that were not included in the audit report.

- 6.1.2 Persons who would normally attend the closing meeting are:

- Client management and key subordinates;
- In-charge Auditor,
- Audit Manager, and
- Others with a specific interest, at the discretion of the Audit Manager or client.

- 6.2 If client management decides that a closing meeting would be useful, such meeting should be held within seven (7) business days from the date the draft report is presented to the client.

- 6.2.1 At the conclusion of the closing meeting, agreed minor changes will be indicated on the draft report and the client will sign the last page of the draft report below the word "CONCUR" to signify that the Management responses fairly present his position.

- 6.2.2 If major changes to the draft report are required, a new draft report will be prepared, re-

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viewed with Internal Auditing Management and presented to the client as in 6.1 above. Should a second closing meeting be required, such meeting should be held within two (2) business days after presentation of the new draft report. Should a meeting not be required, the client should sign the last page of the new draft report within two (2) business days from the date the new draft report is presented.

- 6.3 If a closing meeting (6.1 above) is not required, the client will sign the last page of the draft report below the word "CONCUR" to signify that the Management responses fairly represent his position. Such concurrence is required within seven (7) business days from the date the draft report is presented.
- 6.4 At the expiration of the time periods set forth above (6.2 and 6.3) the Associate General Auditor (AGA) will review the factors involved in any absence of the client's concurrence. If the Associate General Auditor assesses that the absence of the client's concurrence does not warrant delaying issuance, the audit report will be signed by the AGA and issued without the client's concurrence.

7.0 FINAL REPORT PREPARATION AND DISTRIBUTION

- 7.1 After obtaining the "CONCUR" signature of the client, or upon waiver of this requirement as allowed for in 6.4 above, Internal Auditing will prepare the report in final form, incorporating all agreed changes.
- 7.2 Normally audit reports will be distributed to:

Addressee: Client's immediate supervisor (not lower than a Department Head).
 cc: Executive Director or Vice President (unless as addressee)
 General Manager (unless as addressee)
 Client (2)
 President & CEO (when client is in the Finance Organization)
 Business Line Head (if the report includes repeat recommendations)
 Senior Vice President, Finance & Controller
 Manager APM&SD
 External Auditors
 Other persons as considered appropriate by the Associate General Auditor

More limited distribution may occur at the discretion of the General Auditor when an audit report is dealing with unusually sensitive matters.

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8.0 HIGH SPOT REVIEWS

- 8.1 These types of reviews are not substitutes for regularly scheduled audits and are substantially less in scope than a regular audits. They are reviews of selected internal controls, based on management requests / concerns or follow-ups on recommendations and are intended to keep Management informed regarding controls on a current basis.
- 8.2 Field memorandum may be used. The results of the review will be communicated in a High Spot Review report at the conclusion of the review and will normally be discussed with the client prior to release.
- 8.3 The High Spot Review report will be addressed to the client with a copy to the client's immediate supervisor (not lower than a Department Head). The business line head will be furnished a copy of all reports which contain repeat recommendations.
- 8.4 The purpose of these types of reports is to focus Management attention on areas for improvement. A formal response will be required and the draft High Spot Review report will be handled in accordance with paragraphs 6.1 to 6.4 above. The APM&SD will follow-up to monitor implementation of the recommendations in such reports. Follow-up in these cases will be in accordance with paragraphs 12.1 to 12.5 below.

9.0 SPECIAL AUDITS

- 9.1 Special audits are conducted on an "ad hoc" basis. Special audits are primarily forensic audits of accounting records and controls, and any other irregular business matters designed to go beyond the normal scope of the regularly scheduled audits.
- 9.2 Special audits are coordinated at the direction of the General Auditor usually at the Executive Management level. Depending on the circumstances, special audit observations may not be coordinated at the Department level. Field memorandum are not usually issued in the process of special audits.
- 9.3 ** Special audits reports will be addressed and distributed as directed by the General Auditor. Generally, Special audits reports are strictly confidential and shall not be copied, disseminated to any person who is not identified by the General Auditor as a copy recipient. Also Special audits reports shall not be given to any employee or third party who is the subject of the Special Audits inquiry.
- 9.4 Special audits may require responses from the client. In those cases, responses will be handled in accordance with paragraphs 6.1 to 6.4 above. The Controller via APM&SD will follow-up to monitor implementation of the recommendations in such reports.

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- 9.5 Special audit summaries on Company irregularities are prepared quarterly for the President and Chief Executive Officer and semi-annually for the Audit Committee of the Board of Directors if there are items of significance.

10.0 Development Reviews

- 10.1 This type of review relates to application systems under development or major enhancement(s) of existing systems. The goal is to assess the quality of the system development process, the intended controls within the computer system, the external controls which will be exercised by the business function using the system, and the computer environment in which the system will operate.
- 10.2 The purpose of these reviews is to increase user awareness and commitment to controls, encourage the inclusion of cost effective controls in the design of new systems, give guidance regarding the installation of effective transaction audit trails, and recommend ways to reduce exposure to business disruptions. Development Reviews should cover both in-house developed software and vendor purchased software.
- 10.3 Interim audit reports will be issued at least annually for Development Reviews of long-term systems projects. These reports will be issued upon the completion of a project phase or at the end of each calendar year. A final report will be issued upon final project completion.

11.0 SUMMARY REPORTS TO CORPORATE MANAGEMENT AND THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

- 11.1 On a quarterly basis, Internal Auditing sends letters to Corporate Management summarizing control issues within their respective organizations that are significant to warrant their attention. A further summary letter is prepared for the President and Chief Executive Officer.
- 11.2 Once a year, or as requested, the General Auditor reports to the Audit Committee of the Board of Directors regarding selected audit observations and recommendations which the General Auditor determines are of interest to the Committee.

12.0 FOLLOW-UP ON MANAGEMENT RESPONSES TO INTERNAL AUDIT OBSERVATIONS AND RECOMMENDATIONS

- 12.1 The Controller's organization is responsible for administering an audit follow-up system to monitor the proper implementation of audit recommendations. This responsibility, implemented via APM&SD, includes reviewing of the progress reports of the client for implementing audit recommendations and the preparation of a formal response thereto, after having:

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- Reviewed the action plan of the client Department Head or Management of a subsidiary company and the reasons cited for any exceptions noted therein;
- Reviewed with Internal Auditing the adequacy of action taken by Management to implement audit recommendations, if the action to be taken is not clear to APM&SD or requested by Internal Auditing;
- Reviewed progress on open items and justifications for items proposed as "closed";
- Resolved with the client Department Head or Management of a subsidiary company outstanding issues or exceptions; and
- Resolved situations with the client Department Head or Management of a subsidiary company where concurrence to "close" an item has not been given.

12.2 The client Department Head or Management of a subsidiary company is responsible for implementing audit recommendations or obtaining the approval of Executive Management and concurrence of the Business Line Head to waive an audit recommendation with which he does not agree. Until each audit recommendation is closed in such a manner, it will be considered an open item and must be reported on as outlined in 12.3 below.

12.3 * Thirty days after the issuance of an audit report, the client Department Head or Management of a subsidiary company is required to report to APM&SD his action plan to implement the audit recommendations. Follow-up reports should be submitted every sixty (60) days after the initial action plan report until each audit recommendation has been closed unless the item is classified as a long term EDP project recommendation. The client Department Head or Management of a subsidiary company is to confirm in writing to APM&SD that the audit recommendation has been fully implemented or that he has obtained the written approval and concurrence of the appropriate members of Executive and Corporate Management to waive such audit recommendation. The initial and any subsequent progress reports should provide the following as appropriate:

12.3.1 The action to be taken on each accepted recommendation. If action has already been taken and Management considers an item corrected or implemented, the action should be described and the items proposed as "closed".

12.3.2 An explanatory statement from Management for a recommendation with which they are not in agreement. With the approval of the Executive Management and concurrence of the Business Line Head the item should be proposed as "closed". The BAC will be advised by the General Auditor of any audit recommendation waived and the BAC may request the waiving Business Line Head to explain his reasons for the waiver.

12.3.3 An action plan schedule of target completion dates for implementing each recommendation. Such items will continue to be reported every sixty (60) days until they are closed.

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12.3.4 A recommendation may be classified as a long term EDP project recommendation if the project implementation date is more than one year after the audit date. The recommendation is then classified as long term by APM&SD, and as such, the regular follow-up reporting procedures do not apply. APM&SD will notify the client Management of the long term classification of the recommendation and subsequently contact the EDP project Management every six months to determine the status of the recommendation until the item is closed. If the item is not closed by the end of the identified phase completion date established for the item, APM&SD will re-classify the item for reporting every sixty (60) days and will notify the EDP project management of their responsibilities to report their action plan every sixty (60) days until the item is closed.

12.4 Audit recommendations that become unreasonably delinquent in their implementation, that is, no reasonable explanation or plan of action is given for the delay in implementation, will be brought by the Controller to the attention of the client's Business Line Head.

12.5 Quarterly, APM&SD will prepare a report to the Controller with a copy to the General Auditor indicating the status of audit recommendations. A cover letter signed by the Controller is attached to each organizational section of the report and sent to the concerned Business Line Head.

12.6 Twice yearly, APM&SD prepares a review of the status of audit recommendations and follow-up for the Board Audit Committee. The presentation indicates the number of audit recommendations that remain open, identifies those that are over one year old and reports the number of repeat recommendations.

13.0 FOLLOW-UP ON MANAGEMENT RESPONSES TO EXTERNAL AUDIT REPORTS

13.1 The Company's independent auditors conduct annual examinations of the financial statements of the Company and its subsidiaries. In addition to an opinion on the financial statements, the independent auditors issue their Report to Corporate Management covering observations and recommendations for improvements in internal controls.

13.2 The independent auditors' observations and recommendations will be communicated by the following means:

13.2.1 Field memorandum will be prepared during the course of the audit to communicate preliminary observations and recommendations. Field memorandum will be addressed to the client Management responsible for the activity covered by the observation.

13.2.2 The client's response to each field memorandum will be solicited at the bottom of each field memorandum. Response to the field memorandum audit observation must be made within seven (7) business days and returned to the independent auditors.

13.2.3 * At the conclusion of the audit, the independent auditors will prepare a draft commen-

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tary report which incorporates the clients' responses to the previously discussed field memorandum. The draft report be issued to the respective clients and to the General Auditor.

- 13.3 APM&SD will review the observations and recommendations made in the independent auditors' Report to Corporate Management and distribute these to the respective client Department Heads. After such distribution, the recommendation implementation follow-up responsibilities within the Company will be administered in accordance with paragraphs 12.1 through 12.6 above. Those recommendations pertaining to Aramco Services Company (ASC) and other subsidiaries, will be handled as follows:

- 13.3.1 * The Controller in ASC will administer the audit follow-up system for external audit reports for ASC, AAC, SPI & SRI. Copies of the ASC quarterly status reports on external audits are to be obtained and maintained on file in APM&SD (Saudi Aramco).
- 13.3.2 The concurrence to waive external audit recommendation as described in 12.2 and 12.3.2 will be by the President of ASC, the President of AOC or the President of the other subsidiaries.

General Auditor