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Report to Congressional Committees

April 2006

UNITED NATIONS

Lessons Learned from Oil for Food Program Indicate the Need to Strengthen UN Internal Controls and Oversight Activities

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Highlights

Highlights of GAO-06-330, a report to congressional committees

UNITED NATIONS

Lessons Learned from Oil for Food Program Indicate the Need to Strengthen UN Internal Controls and Oversight Activities

Why GAO Did This Study

In 1996, the United Nations (UN) Security Council and Iraq began the Oil for Food program to address Iraq's humanitarian situation after sanctions were imposed in 1990. More than $67 billion in oil revenue was obtained through the program, with $31 billion in humanitarian assistance delivered to Iraq.

The 2005 Defense Authorization Act mandated that GAO review the Oil for Food program. GAO reviewed how the UN adhered to five key internal control standards in its stewardship of the program. GAO assessed (1) the program's control environment and (2) key elements of the other internal control standards. GAO also reported on the UN Compensation Commission's progress in paying reparations from Iraq's invasion of Kuwait.

What GAO Recommends

GAO recommends that the Secretary of State and the Permanent Representative of the U.S. to the UN work with member states to encourage the Secretary General to (1) ensure that UN programs with considerable financial risk apply internationally accepted internal control standards and (2) strengthen internal controls throughout the UN, based on lessons from the Oil for Food program. State and the UN responded that they are taking steps to strengthen internal controls at the UN.

www.gao.gov/cgi-bin/getrpt?GAO-06-330.

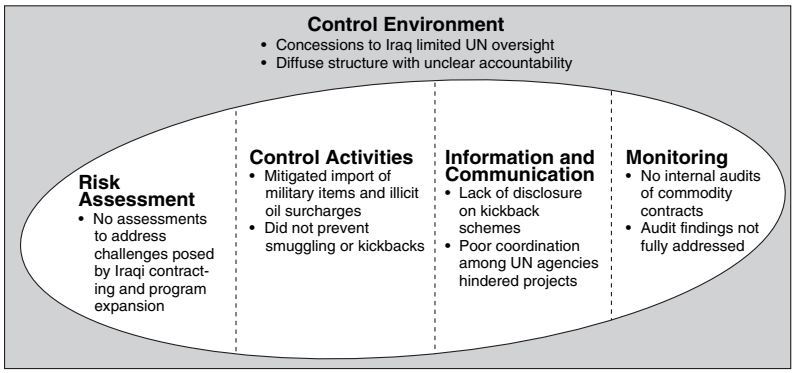
To view the full product, including the scope and methodology, click on the link above. For more information, contact Joseph Christoff at (202) 512-8979 or christoffj@gao.gov.

What GAO Found

The UN Oil for Food program would have benefited from an internationally accepted internal control framework to provide reasonable assurance in safeguarding assets and meeting program objectives. Although the program averted a humanitarian crisis while limiting Iraq's ability to purchase military-related items, internal control problems allowed the former Iraqi regime to manipulate the program and circumvent sanctions to obtain billions of dollars in illicit payments. In particular, weaknesses in the control environment of the Oil for Food program compromised oversight and made it vulnerable to fraud and abuse. For example, Iraq negotiated contracts directly with companies purchasing its oil and selling commodities. In the absence of UN oversight, Iraq manipulated contract terms and obtained kickbacks. Moreover, the program had a complex structure with unclear lines of responsibility and authority. This diffusion among various entities meant that no single entity was accountable for the program in its entirety.

The Oil for Food program also had weaknesses in the four key internal control standards—risk assessment, control activities, information and communication, and monitoring—that facilitated Iraq's ability to obtain illicit revenues ranging from $7.4 billion to $12.8 billion. In particular, the UN did not provide for timely assessments to address the risks posed by Iraq's control over contracting and the program's expansion from emergency assistance to commodities for 24 sectors.

Internal Controls Framework in the Oil for Food Program



Source: GAO.

The UN Security Council established the UN Compensation Commission (UNCC) in 1991 to process claims and pay victims of Iraq's invasion of Kuwait. Security Council resolution 986 provided that a portion of proceeds from Iraq oil sales would go to the compensation fund. The commission approved awards of $52.5 billion to more than 1.5 million claimants and has paid more than $20 billion of this amount; however, Iraq still owes almost $32.2 billion in unpaid awards. Future payments for these awards could extend through 2020. These unpaid awards are in addition to the $51 billion that Iraq owes to international creditors.

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Abbreviations

IMF	International Monetary Fund
OIOS	Office of Internal Oversight Services
OIP	Office of the Iraq Program
SOMO	State Oil Marketing Organization
UN	United Nations
UNCC	United Nations Compensation Commission
UNOHCI	United Nations Office of the Humanitarian Coordinator for Iraq

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United States Government Accountability Office
Washington, DC 20548

April 25, 2006

Congressional Committees:

In 1996, the United Nations (UN) Security Council and Iraq began the Oil for Food program to address growing concerns about Iraq's humanitarian situation after international sanctions were imposed in 1990. Authorized by Security Council resolution 986, the intent of the program was to allow the Iraq government to use the proceeds of its oil sales to pay for food, medicine, and infrastructure maintenance and—at the same time—prevent the regime from obtaining goods for military purposes. Resolution 986 also provided that a portion of the oil sales be used for a separate program to pay compensation through the UN Compensation Commission (UNCC) to victims of Iraq's invasion of Kuwait in 1990. Iraq obtained more than $67 billion in oil revenues through the program; as of November 2003, about $31 billion in commodities and humanitarian assistance had been delivered to Iraq. Four key entities were responsible for most of the program's operations—(1) the Security Council's Iraq sanctions committee, (2) the UN Secretariat's Office of the Iraq Program, (3) nine UN agencies with separate programs in northern Iraq, and (4) the Iraqi government under Saddam Hussein. Allegations of corruption and misconduct within the UN Oil for Food program and the overall management of the humanitarian program have prompted a number of investigations. The 2005 Defense Authorization Act mandated that GAO review the Oil for Food program.[1]

Policymakers and program managers are continually seeking ways to better achieve agencies' missions and program results and improve accountability for results. A key factor in helping to achieve such outcomes is to implement appropriate internal controls. Internal controls, if properly designed and implemented, provide reasonable assurance that objectives are being met; they also serve as the first line of defense in safeguarding assets and preventing fraud, waste, and abuse. A general framework for internal controls is widely accepted in the international audit community and has been adopted by leading accountability organizations, including the International Organization of Supreme Audit

[1]Public Law 108-375, Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, October 2004.

Institutions, the U.S. Office of Management and Budget (OMB), and GAO.[2] The first standard within this framework is the control environment, which provides the structure, discipline, and ethical tone for implementing an internal control system. Other standards focus on employing assessments of the external and internal risks an organization faces; establishing policies and procedures to enforce directives (control activities); providing relevant, timely, and reliable information and communication; and monitoring performance and adhering to audit findings.

Our report uses this internal control framework to identify the key weaknesses in enforcing sanctions against Iraq and implementing the Oil for Food program. Specifically, we assessed (1) aspects of the control environment—the foundation for all internal control standards—that the UN developed and implemented for the Oil for Food program and (2) key elements of the remaining internal control standards—risk assessment, control activities, information and communication, and monitoring. In addition, we report on the activities and progress of UNCC.

To address these objectives, we met with officials from the Departments of State, Defense, Commerce, and Treasury who were responsible for managing the U.S. participation in the Iraq sanctions and Oil for Food program; we also reviewed relevant documents provided by State. We met with UN officials who had worked in the UN Office of the Iraq program (OIP) (the key UN organization responsible for administering the program), UN officials representing several UN specialized agencies, and with UNCC officials in Geneva, Switzerland. We reviewed and analyzed documents related to management and oversight, including audits conducted by the UN Office of Internal Oversight Services (OIOS). We reviewed independent reports, including publications by the UN Independent Inquiry Committee and the Iraq Survey Group.

We conducted our review from February 2005 through January 2006 in accordance with generally accepted government auditing standards. (App. I provides detailed information on our scope and methodology.)

[2]Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control-Integrated Framework*, September 1992.

Results in Brief

UN sanctions and the Oil for Food program averted a humanitarian crisis while limiting Iraq's ability to purchase military-related items, but internal control problems allowed the former Iraqi regime to manipulate the program and circumvent sanctions to obtain illicit payments ranging from $7.4 billion to $12.8 billion.[3] In particular, weaknesses in the control environment compromised the oversight of the Oil for Food program and made it vulnerable to fraud and abuse. First, in the mid-1990s, as Iraq's humanitarian situation worsened, the Security Council and Secretariat made concessions to the Iraqi regime that allowed it to negotiate contracts directly with companies purchasing oil and selling commodities. In the absence of UN oversight of these contracts, Iraq manipulated contract terms and obtained kickbacks. In addition, the Security Council was aware that Iraq smuggled oil to neighboring UN member states in violation of the sanctions but did little to prevent the smuggling, thus allowing Iraq to obtain revenues not authorized by the Oil for Food program. Second, the Oil for Food program had a highly complex organizational structure with unclear lines of responsibility and authority, which contributed to an ineffective control environment. The diffusion of responsibility among numerous entities meant that no single entity was accountable for the program in its entirety. In addition, each entity had weaknesses in its fragmented responsibilities that further undermined management and oversight of the program. Despite this difficult environment, the Oil for Food program averted a major humanitarian crisis by raising the food intake of the Iraqi population and decreasing malnutrition.

The Oil for Food program also had key weaknesses in the key four internal control standards—risk assessment, control activities, information and communications, and monitoring—that facilitated Iraq's ability to obtain illicit revenues.

- **Risk assessment** identifies the internal and external risks an organization faces, determines the likelihood of their occurrence, and forms the basis for a plan to manage those risks. However, the UN conducted no timely assessments to identify and address high-risk areas and prevent fraud, even as the Oil for Food program expanded from the short-term delivery of emergency food and medicine to a multiyear program that included building and repairing infrastructure in 24 civilian sectors. Moreover, in 2000, the Office of the Iraq Program rejected a proposal from the UN's

[3]See appendix III for further information on Iraq's illicit revenues during the Oil for Food program. The ranges given represent estimates developed by GAO, the Independent Inquiry Committee, and the Iraq Survey Group for 1997 through about early 2003.

internal audit office to conduct a risk assessment of the Program Management Division. Timely and comprehensive risk assessments might have identified the lack of systematic reviews of the reasonableness of the prices that the Iraqi government had negotiated with the companies supplying goods and services. Such assessments may also have exposed the lack of clear responsibility and reporting lines among the numerous UN entities managing the program.

- **Control activities** are the policies and procedures that help ensure that management's directives are carried out and risks are addressed. Some control activities were effective and others were not. For example, an insufficient number of oil experts reviewing oil contracts, the lack of oil metering equipment, and limited review of contract prices helped enable Iraq to smuggle oil and levy surcharges and kickbacks on its contracts. In contrast, oversight by the Security Council's Iraq sanctions committee—particularly by U.S. and United Kingdom (U.K.) members—mitigated Iraq's efforts to obtain military equipment by preventing Iraq from importing dual-use items. In addition, the sanctions committee eventually constrained Iraq's ability to impose up-front surcharges on oil contracts by setting prices for Iraqi oil after the oil was delivered to the buyer.

- **Information and communication** that is relevant, reliable, and timely is needed for an organization to control its operations. However, the Office of the Iraq Program did not inform the sanctions committee of suppliers' allegations that Iraq demanded contract kickbacks and hidden fees and did not disclose information on Iraq's oil smuggling through Syria. Moreover, none of the Secretariat's required 90- or 180-day reports to the Security Council mentioned illicit payment demands in connection with oil or commodity contracts. In addition, poor communication and coordination among UN agencies led to delays in completing housing projects in northern Iraq.

- **Monitoring** assesses performance over time and ensures that the findings of audits and other reviews are promptly resolved. OIOS identified more than 700 problems with the Oil for Food program and compensation fund.[4] However, limitations on the auditors' reporting scope and resources hindered their effectiveness as an oversight tool. For example, OIOS only had two to six auditors assigned to the Oil for Food program and did not review commodity contracts for central and southern Iraq, which

[4]GAO, *United Nations: Oil for Food Program Audits*, GAO-05-346T (Washington, D.C.: Feb. 15, 2005).

comprised 59 percent of the program. Nonetheless, OIOS audits of the Oil for Food program in northern Iraq found more than 400 recurring problems in procurement, cash and asset management, planning and coordination, and personnel. The recurring nature of these problems over the course of the program demonstrated that systemic weaknesses were not fully addressed.

In addition to the Oil for Food program, UN Security Council resolutions required Iraq to reserve up to 30 percent of its oil proceeds to compensate victims of its invasion of Kuwait; this amount was reduced to 5 percent in 2003. UNCC has approved awards totaling $52.5 billion to more than 1.5 million claimants and paid about $20.3 billion of this amount to individuals and families with smaller claims. However, Iraq owes corporations, governments, and international organizations almost $32.2 billion in unpaid awards. Depending on the growth of Iraq's oil revenues, it may take nearly 14 years to pay the remaining compensation awards. These unpaid awards are in addition to the estimated $51 billion that Iraq owes to international creditors.[5]

We are recommending that the Secretary of State and the Permanent Representative of the United States to the UN work with other member states to encourage the Secretary General to (1) ensure that UN programs with considerable financial risks establish, apply, and enforce the principles of internationally accepted internal control standards, with particular attention to comprehensive and timely risk assessments and (2) strengthen internal controls throughout the UN system, based in part on the lessons learned from the Oil for Food program.

We provided a draft of this report to the Secretary of State, the UN Deputy Secretary General, and the UN Compensation Commission for comment. We received written responses from State and UNCC and oral comments from the UN. However, State commented that our first recommendation would apply only to future sanctions programs similar to the Oil for Food Program. We have modified our recommendation to clarify that the principles of oversight and control should apply to future UN programs with considerable financial risk, not merely programs similar to the Oil for Food program. The UN concurred with our recommendations and noted

[5]International Monetary Fund, *Iraq: Request for Stand-By Arrangement* (Washington, D.C.: Dec. 7, 2005).

that it is taking steps to strengthen internal control throughout the organization.

Regarding our findings, State noted that our report (1) does not clearly distinguish between the responsibilities and actions of the Secretary General and the Security Council, (2) does not highlight the Security Council's inaction on corruption in the sanctions regime, (3) overstates the case that no single entity was in charge of the program, and (4) overly focuses on internal controls which would not have corrected the problems without political will. We disagree. Our report distinguishes between the responsibilities and actions of the Secretary General and the Security Council; when both entities are responsible, our report refers collectively to the UN. We also fully discuss how the Security Council's inaction facilitated oil smuggling to neighboring states in violation of UN sanctions. Moreover, the diffusion of responsibility among multiple UN entities was a major structural weakness of the program and contributed to unclear authority, manipulation, and weak oversight. We also believe that State underestimates the importance of a control framework that, if in place, would have identified the program's vulnerabilities and established clear lines of authority for responding to the program's mismanagement and corruption.

UNCC stated that we should not include it in our report because it would unfairly taint UNCC with the problems ascribed to the Oil for Food Program. We have modified the report to distinguish the roles and responsibilities of UNCC from those of the UN Oil for Food program. UNCC also commented that our report does not adequately describe its organization and its relationship with the internal auditors; we have added more information about these topics.

Background

In 1990, Security Council resolution 661 imposed economic sanctions on Iraq in response to its invasion and occupation of Kuwait, thereby prohibiting all countries from buying Iraqi goods and selling most commodities to Iraq. In 1995, in response to growing international concern over the impact that sanctions were having on the humanitarian situation in Iraq, Security Council resolution 986 authorized Iraq to sell up to $1 billion worth of oil every 90 days to pay for food, medicine, and humanitarian goods. Iraq first exported oil under the Oil for Food program in December 1996, and the first shipments of humanitarian goods arrived in March 1997. The Security Council subsequently increased the amount of oil that Iraq could sell and expanded the types of humanitarian goods that it could import. In 1999, the Security Council removed all restrictions on

the amount of oil Iraq could sell to purchase civilian goods. The Security Council implemented the program in 13 6-month phases. In May 2003, Security Council resolution 1483 requested the UN Secretary General to transfer the Oil for Food program to the U.S.-led Coalition Provisional Authority by November 2003. At that time, the Coalition assumed responsibility for managing Iraq's oil proceeds and outstanding commodity contracts.

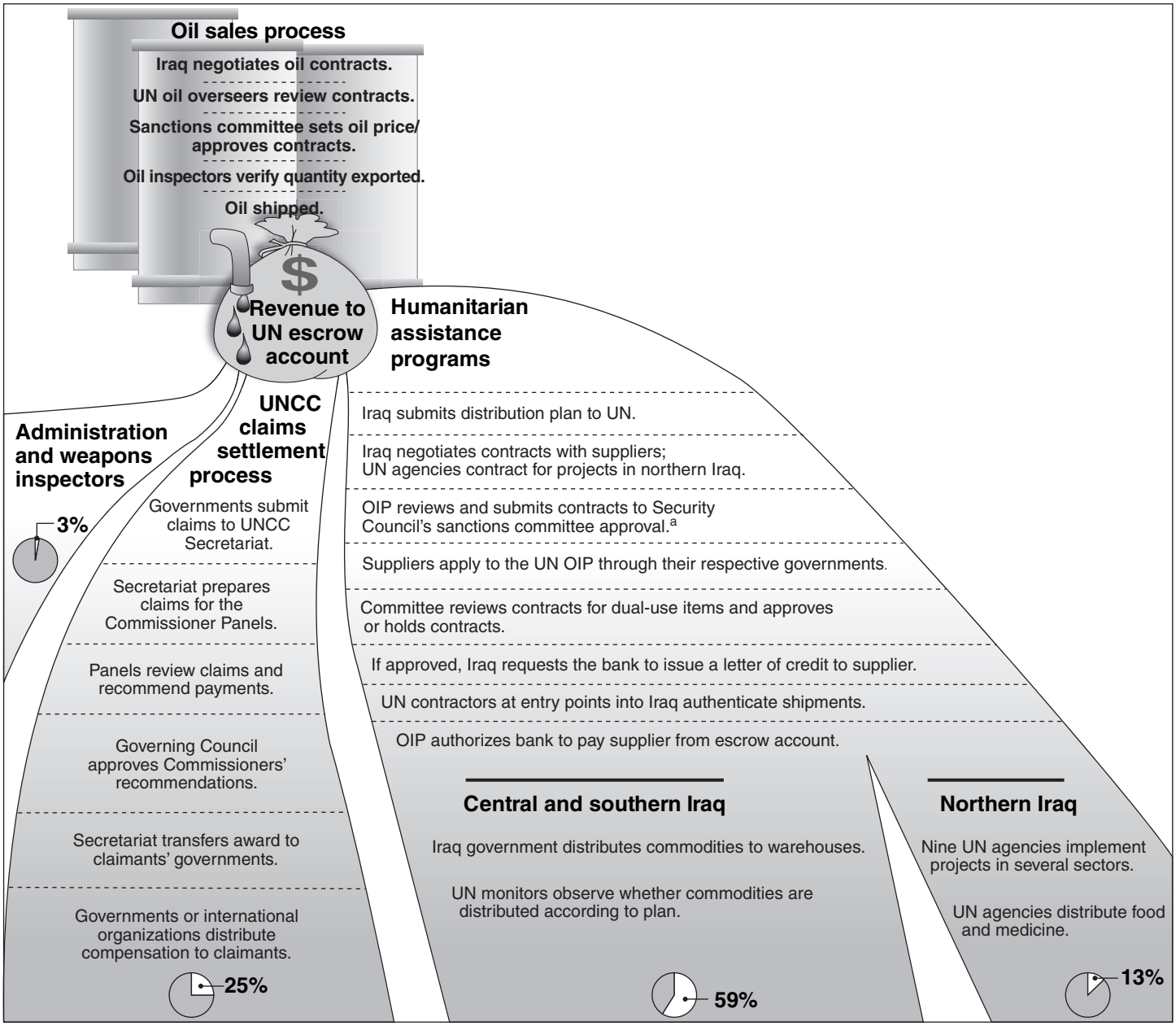
In addition to UN sanctions, the Security Council established UNCC in 1991 to pay compensation for damages and losses resulting from Iraq's invasion and occupation of Kuwait.[6] Advances from the UN Working Capital Fund; voluntary contributions from governments; and proceeds, from Iraqi oil sold after the invasion of Kuwait, that had been frozen by various governments funded the UNCC for several years after its establishment. With the adoption of Security Council resolution 986 in 1995, UNCC received 30 percent of Iraqi oil proceeds to fund the compensation program. Subsequent resolutions in 2000 and 2003 reduced the amount of oil proceeds the UNCC received to 25 and 5 percent, respectively.

At the time UNCC was receiving 25 percent of Iraqi oil proceeds, the UN allocated 59 percent of proceeds for humanitarian assistance in the 15 central and southern governorates, 13 percent for assistance to the three northern Kurdish governorates, and 3 percent for UN administrative costs. Figure 1 illustrates the programs and activities funded by Iraq's oil proceeds in accordance with Security Council resolution 986. Iraq's state-owned marketing company negotiated the oil contracts, and the Security Council's Iraq sanctions committee approved these contracts and oil prices, on the basis of advice from independent oil experts. Once the oil was shipped, the purchasing company deposited the proceeds into a UN-controlled escrow account. Iraq negotiated contracts for the commodities it purchased for the central and southern governorates as well as bulk food and medicine contracts for the entire country. The suppliers, through their national governments, sent contracts to OIP and the sanctions committee for approval. When the items arrived in Iraq, inspectors verified them against appropriate documentation and notified the UN treasurer that it could pay the supplier from the escrow account. In northern Iraq,

[6]Security Council resolution 687 of April 3, 1991, states that Iraq is liable, under international law, for any direct loss or damages, including "environmental damage and the depletion of natural resources, or injury to foreign Governments, nationals and corporations."

UN agencies distributed the food and medicine purchased by the central government and implemented projects in several sectors. Appendix II contains additional information on processes related to oil sales, commodity purchases, and the program in northern Iraq.

Figure 1: Programs and Activities Authorized by Security Council Resolution 986



Sources: GAO and UN (data); Art Resources (clip art).

[a]The Security Council shifted more approval authority for humanitarian items to OIP in 1999 and 2002.

The Committee of Sponsoring Organizations of the Treadway Commission developed the internationally accepted and widely used framework and standards for internal control used in this report. These standards were used as a basis for the internal control standards and guidance issued by (1) GAO,[7] (2) the International Organization of Supreme Audit Institutions (INTOSAI),[8] and (3) OMB Circular A-123, "Management's Responsibility for Internal Control." According to these standards, internal controls, if properly designed and implemented, provide reasonable assurance that objectives are being met and serve as the first line of defense in safeguarding assets and preventing fraud. Within this framework,

- the control environment establishes and maintains an environment that sets a positive and supportive attitude toward internal control,
- risk assessment identifies and analyzes internal and external risks and forms a basis for determining how these challenges should be managed,
- control activities are the policies and procedures that help ensure that management directives are followed,
- information and communication are timely and help enable managers and others to perform their internal control responsibilities, and
- monitoring assesses performance over time and helps to ensure that audit findings and other issues are promptly resolved.

Early Compromises in Program Structure and Widely Diffused Management Responsibilities Led to Weak Control Environment

The Oil for Food program suffered from two key weaknesses in the control environment that led to weak oversight and enabled the former Iraqi regime to circumvent the sanctions and obtain billions of dollars in illicit contract revenues. First, the UN Secretariat negotiated and the Security Council approved an agreement that allowed the Iraqi government, a country under international sanctions, to negotiate contracts directly with purchasers of Iraqi oil and suppliers of commodities and to control the internal distribution of its imported items. The UN was under considerable pressure at this time to respond to Iraq's humanitarian crisis. Nonetheless, this structure was an important factor in

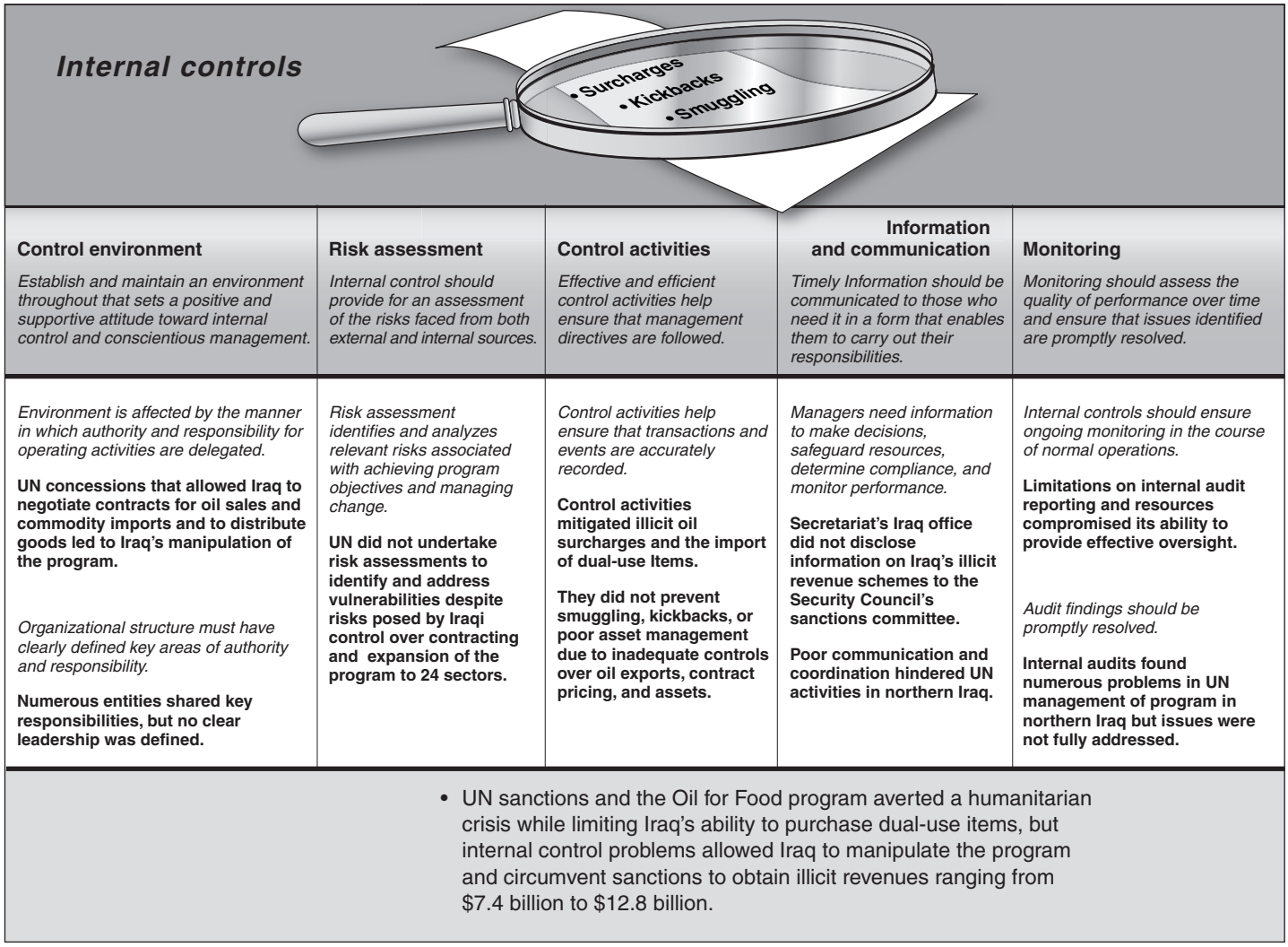
[7]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

[8]INTOSAI, *Guidelines for Internal Control Standards for the Public Sector* (Vienna, Austria: 2004).

enabling Iraq to manipulate contracts. In addition, the Security Council was aware that Iraq smuggled oil to neighboring UN member states in violation of the sanctions but did little to prevent the smuggling. The Security Council relied on these neighboring states to enforce the sanctions against Iraq that were related to military and dual-use items but allowed these countries to continue illicit trade with Iraq, thus enabling the regime to obtain illicit funds.

Second, management and oversight of the program were diffused among more than a dozen UN and international entities, with no single entity in charge of and accountable for the program. Figure 2 summarizes the internal control weaknesses in the Oil for Food program, including the control environment. Subsequent sections of this report will discuss the additional control standards.

Figure 2: Internal Control Standards Related to UN Sanctions against Iraq and the Oil for Food Program



Source: GAO.

The Oil for Food Program Included Compromises that Limited UN Oversight

In establishing the Oil for Food program, the UN made two major concessions to the former Iraqi regime that allowed it to (1) retain control over the negotiation of contracts and the distribution of imported goods and (2) trade with neighboring countries outside the Oil for Food program.

When the UN first proposed the Oil for Food program in 1991, it recognized the vulnerability inherent in allowing Iraqi control over the

contracting process. At that time, the Secretary General proposed that the UN, an independent agent, or the Iraqi government be given the responsibility to negotiate contracts with oil purchasers and commodity suppliers. However, the Secretary General subsequently concluded that it would be highly unusual or impractical for the UN or an independent agent to trade Iraq's oil or purchase commodities and recommended that Iraq negotiate the contracts and select the contractors. Nonetheless, he stated that the UN and Security Council must ensure that Iraq's contracting did not circumvent the sanctions and was not fraudulent. Accordingly, the Security Council proposed that UN agents review contracts and compliance at Iraq's oil ministry. Iraq refused these conditions.

In April 1995, as humanitarian conditions worsened, the Security Council passed resolution 986 to permit Iraq to use its oil sales to finance humanitarian assistance. The UN reported that the average Iraqi's food intake was about 1,275 calories per day, compared with the standard requirement of 2,100 calories. Against a backdrop of pressure to maintain sanctions while addressing emergency humanitarian needs, the UN conceded to Iraq's demand that it retain independent control over contract negotiations. Accordingly, a May 1996 memorandum of understanding[9] between the UN and Iraq allowed Iraq to directly tender and negotiate contracts without UN oversight and to distribute imported goods to the intended recipients.

When the Oil for Food program began, the UN was responsible for confirming the equitable distribution of commodities, ensuring the effectiveness of program operations, and determining Iraq's humanitarian needs. According to the memorandum of understanding, the Iraqi government was to provide UN observers with full cooperation and access to distribution activities. However, observers faced intimidation and restrictions from Iraqi regime officials in carrying out their duties. According to a former UN official, observers could not conduct random spot checks and had to rely on distribution information provided by ministry officials, who then steered them to specific locations. The

[9] *Memorandum of Understanding between the Secretariat of the United Nations and the Government of Iraq on the Implementation of Security Council Resolution 986* (1995), May 20, 1996.

Independent Inquiry Committee[10] reported that observers were required to have government escorts and cited various instances of intimidation and interference by Iraqi officials. The committee concluded that limits placed on the observers' ability to ask questions and gather information affected the UN Secretariat's ability to provide full and complete field reports to the sanctions committee.

Concessions to regional trade activity further affected the control environment and allowed the Iraqi regime to obtain revenues outside the Oil for Food program. Although oil sales outside the program were prohibited, the Security Council's Iraq sanctions committee did not address pre-existing trade between Iraq and other member states. Illicit oil sales were primarily conducted on the basis of formal trade agreements. For example, trade agreements with Iraq allowed Jordan—a U.S. ally dependent on Iraqi trade—to purchase heavily discounted oil in exchange for up to $300 million in Jordanian goods. Members of the sanctions committee, including the United States, took note of Iraq's illicit oil sales to its neighbors, but took no direct action to halt the sales or punish the states or entities engaged in them. In this regard, the UN relied on Iraq's neighboring countries to enforce the sanctions prohibiting Iraq from obtaining military and dual-use items. However, these states formally protested the economic sanctions, citing commercial harm to their economies. Successive U.S. administrations also issued annual waivers to Congress exempting Turkey and Jordan from unilateral U.S. sanctions for violating the UN sanctions against Iraq.

According to U.S. government officials and oil industry experts, Iraq smuggled oil through several routes. Oil entered Syria by pipeline, crossed the borders of Jordan and Turkey by truck, and was smuggled through the Persian Gulf by ship. Syria received up to 200,000 barrels of Iraqi oil a day in violation of the sanctions. Oil smuggling also occurred through Iran. The Security Council authorized the Multinational Interception Force in the

[10]In April 2004, the UN established the Independent Inquiry Committee, headed by Paul Volcker, the former Chairman of the U.S. Federal Reserve, to investigate the administration and management of Oil for Food program. Its scope included investigating allegations of fraud and corruption on the part of UN officials, personnel, and agents that entered into contracts with the UN or with Iraq under the program.

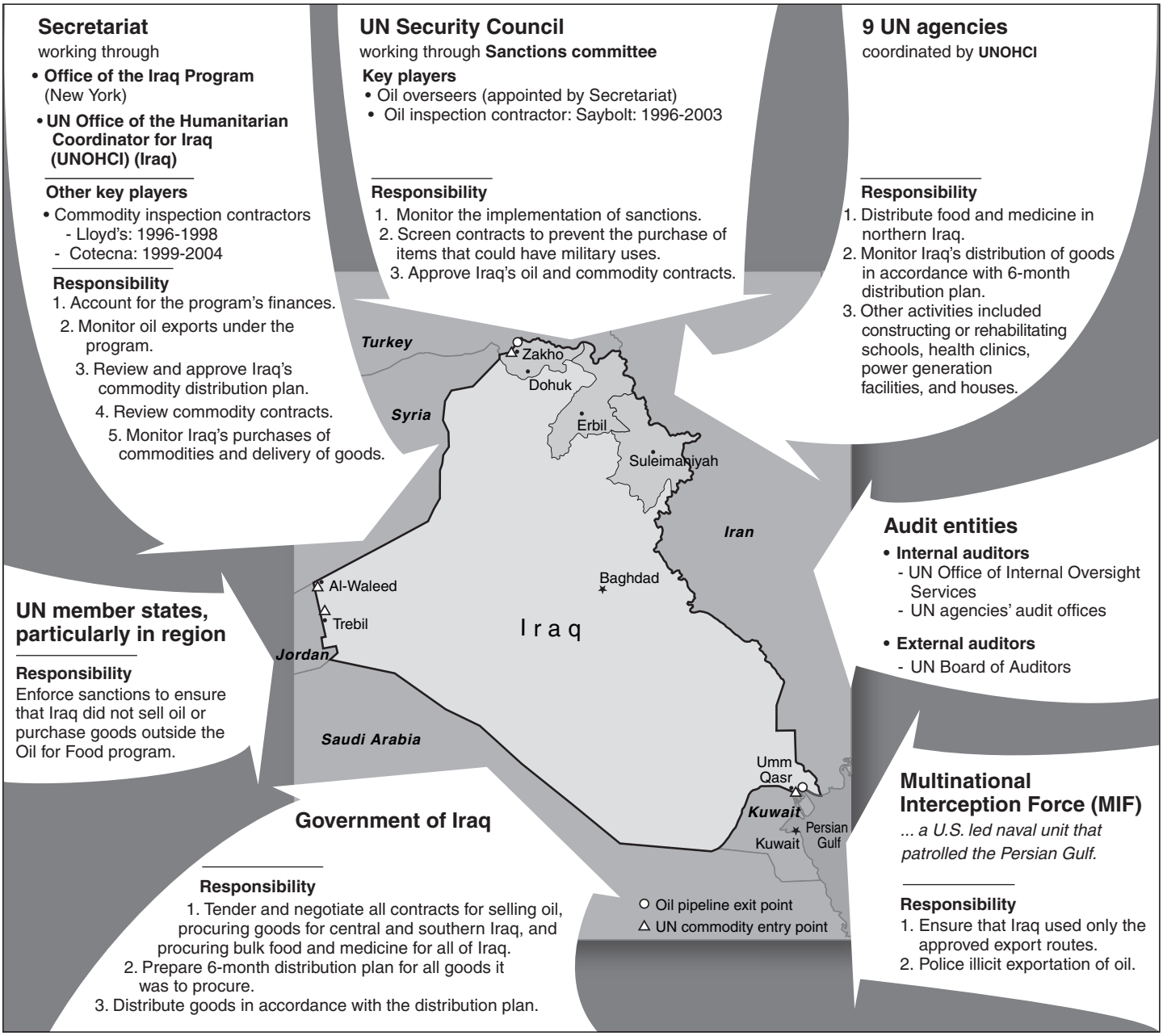
Persian Gulf; but, according to the Department of Defense, it interdicted only about 25 percent of the oil smuggled through the Gulf.[11]

Numerous Entities Shared Key Responsibilities, but Authority and Accountability Were Not Clearly Defined

Both OIP, as an office in the UN Secretariat, and the Security Council's Iraq sanctions committee were responsible for the management and oversight of the Oil for Food program. The Iraq government, other UN agencies, UN member states, the interdiction force in the Persian Gulf, inspection contractors, and internal and external audit offices also played specific roles. However, no single entity was accountable for the program in its entirety. (See fig. 3 for an illustration of these entities and their roles.) In 2005, the Independent Inquiry Committee reported that the Security Council had failed to clearly define the program's broad parameters, policies, and administrative responsibilities and that neither the Security Council nor the Secretariat had control over the entire program. The absence of clear lines of authority and reporting were important structural weaknesses in a program that allowed the sanctioned Iraq regime initiative and control over program design and implementation. In addition, each entity had weaknesses in their fragmented responsibility that further undermined oversight and management of the Oil for Food program.

[11]GAO, *Weapons of Mass Destruction: UN Confronts Significant Challenges in Implementing Sanctions Against Iraq*, GAO-02-625 (Washington, D.C.: May 23, 2002).

Figure 3: Multiple Organizations Managed the Oil for Food Program and Enforced UN Sanctions



Sources: GAO (data) and United Nations (map).

- In October 1997, the UN Secretariat created the Office of the Iraq Program to administer the Oil for Food program. OIP's responsibilities included key oversight aspects of the program, including (1) accounting for the program's finances, (2) monitoring oil exports under the program, (3) approving Iraq's plans for distributing imported commodities, (4) reviewing commodity contracts, (5) monitoring Iraq's purchases of commodities and delivery of goods, and (6) reporting to the Security Council every 90 and 180 days. In 2005, the Independent Inquiry Committee reported that the Secretariat had not clearly defined OIP's responsibilities and that OIP had lacked clear authority to reject contracts based on pricing concerns.

- The UN Office of the Humanitarian Coordinator for Iraq (UNOHCI) administered OIP's field operations in Iraq. The field unit's functions included monitoring and reporting, ensuring the efficient and equitable distribution of goods within Iraq, and overseeing the separate Oil for Food program in northern Iraq. However, the Independent Inquiry Committee found that OIP had not clearly defined the responsibilities and reporting lines of UNOHCI's and OIP's Program Management Division, which served as a headquarters liaison to the field. The lack of clarity led to confusion over the division's role in coordinating field activities and diminished its ability to provide quality control over the field's observation and reporting mechanisms.

- The Secretariat also contracted inspection companies to inspect humanitarian supplies imported into Iraq at three entry points. However, the inspectors' duties were mostly limited to comparing letters of credit for commodities to the shipping documents supplied at the border and visually inspecting about 7 to 10 percent of the goods. They only inspected goods presented by the transporter and did not inspect goods arriving in non-Oil for Food lanes.

- The UN Security Council shared key oversight responsibilities through its Iraq sanctions committee, which was comprised of representatives from the 15 Security Council members. The sanctions committee was first created in 1990 as part of Security Council resolution 661 to monitor compliance with UN sanctions against Iraq. In 1995, resolution 986 directed the sanctions committee to also monitor the Oil for Food program. The committee was responsible for (1) monitoring the implementation of sanctions, (2) screening commodity contracts to prevent the purchase of items that could have military uses, and (3) approving Iraq's oil and commodity contracts. The committee's review of commodity contracts focused on whether the contracts contained items of potential military use, or so-called dual-use items. It did not review

contracts for price and value. In addition, it operated by unanimous consensus, which, according to the Independent Inquiry Committee, weakened its ability to undertake investigations of illicit activity or take remedial action. The Independent Inquiry Committee also noted that, although the sanctions committee was a monitoring body, its rules did not require it to take action in response to reports of sanctions or Oil for Food program violations, except for information indicating illegal arms trafficking.

The Iraq sanctions committee's responsibilities for reviewing commodity contracts lessened over time. From the beginning of the program until 1999, the committee was responsible for approving all contracts. However, in 1999, the Security Council shifted more approval responsibilities to OIP. Due to concerns about the humanitarian situation in Iraq and pressure to expedite the review process, Security Council resolution 1284 in December 1999 directed the sanctions committee to accelerate the review process. The committee subsequently allowed OIP to approve contracts for food, medical supplies, and equipment for the agricultural, water and sanitation, housing, and electricity sectors.

However, political pressure on the UN continued, and U.S. officials asserted that support for international sanctions enforcement was collapsing. According to a congressional report,[12] the United States proposed targeted sanctions in early 2001 to reduce criticism by other Security Council members of continuing the sanctions and to help rebuild consensus on containing Iraq. In May 2002, OIP began approving contracts if they did not contain any items on a list of dual-use items known as the goods review list.[13]

The rules of the Iraq sanctions committee provided for four oil experts to assist the committee. The oil overseers were responsible for ensuring that oil sales contracts complied with program requirements and helped the committee determine oil prices. However, for a 14-month period in 1999 and 2000, only one overseer reported to the sanctions committee. In

[12]Congressional Research Service, *Iraq: Oil-for-Food Program, Illicit Trade, and Investigations*, RL30472 (Washington, D.C.: Jan. 9, 2006).

[13]Two UN inspection bodies assigned to monitor Iraq's military and weapons of mass destruction programs—(1) the UN Monitoring, Verification, and Inspection Committee and (2) the International Atomic Energy Agency—examined commodity contracts to see if they contained items on the goods review list. Items that were covered by the goods review list, not entire contracts, were forwarded to the sanctions committee for further review.

addition, the Secretariat contracted with Saybolt Eastern Hemisphere B.V. to oversee the export of oil and oil products from Iraq through approved export points. The agents were expected to monitor oil leaving Iraq under the Oil for Food program and were authorized to stop shipments if they found irregularities. However, they were not required to monitor or report on oil smuggled outside the Oil for Food program in violation of international sanctions.

- Nine UN agencies,[14] ran the Oil for Food program in northern Iraq. They were responsible for distributing food rations and medicine in the three Kurdish governorates and for other activities, such as constructing or rehabilitating schools, health clinics, power generation facilities, and houses. However, the Independent Inquiry Committee and OIOS reported numerous instances of poor coordination and communication among the agencies and UNOHCI as well as problems with procurement and financial and asset management.

- Other entities involved in the sanctions program included UN member states and the Multinational Interception Force. UN member states, particularly those in the region, were responsible for enforcing the sanctions to ensure that Iraq did not sell oil or purchase goods outside the Oil for Food program, but oil smuggling and trade with Iraq's neighbors outside the program occurred. The U.S.-led Multinational Interception Force, a naval unit that patrolled the Persian Gulf to prevent illicit oil exports, was responsible for ensuring that Iraq used only approved export routes, but it only interdicted about 25 percent of the oil smuggled through the Persian Gulf.

- The Iraqi government tendered and negotiated contracts for selling its oil and procuring goods for the 15 central and southern governorates and also procured bulk food and medical supplies for all of Iraq, including the three northern governorates. It was also responsible for developing a distribution plan every 6 months for the commodities it planned to procure and for ensuring the distribution of these commodities in accordance with the plan. Iraqi control over the contracting and distribution processes allowed it to manipulate contract terms for illicit revenues and to restrict the efforts of UN observers responsible for monitoring the distribution of humanitarian goods.

[14]Agencies included the Food and Agricultural Organization; International Labor Organization; World Food Program; World Health Organization; UN Children's Fund; UN Development Program; UN Educational, Scientific, and Cultural Organization; UN-Habitat; and the UN Office for Project Services.

- OIOS, the internal oversight office within the Office of the Secretariat, conducted audits of the Oil for Food program and the separate UNCC program and reported the results to OIP's executive director and the UNCC's executive secretariat, respectively. OIOS issued 55 audits and two summary reports and have several ongoing audits at UNCC. Although OIOS identified more than 700 problems in all these reports, including 430 in more than 20 audits of program activities in northern Iraq, its effectiveness as an accountability tool was compromised by lack of resources and its limited scope. In addition to OIOS, UN external auditors conducted audits on the condition of the escrow account holding Iraq's oil proceeds, and the internal auditors of the UN agencies implementing the program in northern Iraq conducted audits of their agencies' Oil for Food activities.[15] The audit units of these UN agencies conducted 66 audits of the program. According to the Independent Inquiry Committee, these reports identified weaknesses and made several recommendations for improvement.

Despite the difficulties posed by fragmented implementation and unclear oversight, the Oil for Food program did provide emergency humanitarian relief to the Iraqi people. The Independent Inquiry Committee reported that the food provided through the Oil for Food program reversed a serious and deteriorating food crisis, preventing widespread hunger and probably reducing deaths in which malnutrition was a factor. The UN also reported that average daily caloric intake almost doubled, and malnutrition rates for children under age 5 fell by more than half during the program.

Oil for Food Program Fell Short of Additional Internal Control Standards

The Oil for Food program and the Iraq sanctions fell short in the remaining four key internationally accepted standards for internal control—conducting risk assessments, implementing control activities, ensuring adequate information and communication, and monitoring. The lack of fundamental controls—particularly in light of the vulnerabilities inherent in the control environment—facilitated the regime's ability to obtain illicit payments ranging from $7.4 billion to $12.8 billion. Figure 2 summarizes some of our key findings about the UN's internal controls within these standards.

[15]With the exception of UN-Habitat, all UN agencies had their own internal audit functions. UN-Habitat's activities were audited by OIOS.

Key Weaknesses and Challenges Were Not Addressed Due to Absence of Risk Assessments

Risk assessment is used to identify and manage internal and external risks that can affect a program's outcomes and accountability, including those risks that emerge as conditions change. The Oil for Food program expanded rapidly as it evolved from an emergency 6-month measure to provide humanitarian needs to a program that delivered about $31 billion in commodities and services in 24 sectors for more than 6 years. When the international community was not satisfied with Iraq's compliance with weapons inspections, the Security Council continued the sanctions and expanded its initial emphasis on food and medicines to include infrastructure rehabilitation and activities in 14 sectors. These sectors included food, food handling, health, nutrition, electricity, agriculture and irrigation, education, transport and telecommunications, water and sanitation, housing, settlement rehabilitation for internally displaced persons, demining, a special allocation for vulnerable groups, and oil industry spare parts and equipment. In June 2002, the Iraqi government introduced another 10 sectors, including construction, industry, labor and social affairs, youth and sports, information, culture, religious affairs, justice, finance, and the Central Bank of Iraq.

The Security Council and UN Secretariat did not assess the risks posed by this expansion, particularly in light of the fact that they had relegated responsibility for the contracting process to Iraq. OIOS was the only entity that attempted to assess the enormous risks in the Oil for Food program, but OIP blocked that attempt. In August 2000, the Under Secretary General for OIOS proposed an overall risk assessment to the Deputy Secretary General to improve the program by identifying the factors that could prevent management from fulfilling the program's objectives. The proposal noted that this assessment could be a model for other UN departments and activities. OIOS considered the Oil for Food program a high-risk activity and decided to focus on an assessment of OIP's Program Management Division. This unit was responsible for providing policy and management advice to OIP's executive director and for supporting UNOHCI in its field implementation and observation duties. In May 2001, OIP's executive director refused to fund the risk assessment, citing financial reasons and uncertainty over the program's future. However, the Independent Inquiry found that, about the same time, OIP moved to a new office in New York with increased rental costs and refurbishments totaling about $3 million.

In July 2003, OIOS issued an assessment of OIP's Program Analysis, Monitoring, and Support Division—formerly the Program Management Division—that identified a number of organizational, management, and administrative problems, including poor communication and coordination, unclear reporting lines among OIP headquarters units and the field, and

the lack of approved work plans. However, by this date, the UN was preparing for the November 2003 transfer of the program to the Coalition Provisional Authority, and the report was of limited usefulness for addressing high-risk areas. Timely risk assessments might have identified the internal control weaknesses—such as inadequate contract pricing reviews—that facilitated Iraq's ability to levy illicit contract revenues and the structural management weaknesses that led to ineffective communication and coordination within the program.

Control Activities Mitigated Questionable Oil Pricing and the Import of Dual-Use Items but Did Not Prevent Smuggling, Contract Kickbacks, or Poor Asset Management

Control activities are those activities that help provide assurance that management's directives are carried out and that risks are addressed and include the policies and procedures established to ensure accountability. The Security Council's sanctions committee established some control activities, such as retroactive pricing and review of contracts for items having potential military use, which helped address problems resulting from Iraq's control over the contracting and distribution processes. However, other important control activities for monitoring oil exports and assessing the reasonableness of the prices that Iraq was negotiating were limited or nonexistent, which helped enable Iraq to smuggle oil and levy surcharges and kickbacks on its contracts. In addition, physical control over vulnerable assets is a key control activity, particularly in environments lacking adequate security. However, in northern Iraq, cash and asset management policies were compromised due to the failure to maintain inventory systems or secure cash in UN offices and during transport.

Inadequate Control of Oil Shipments and Oil Export Contracts Facilitated Smuggling and Illicit Surcharges

A limited role for contractors overseeing oil exports and the lack of oil meters facilitated Iraq's ability to obtain revenues from smuggling that ranged from $5.7 billion to $8.4 billion during the course of the Oil for Food program. In 1996, the Secretariat contracted with Saybolt to oversee the export of oil from Iraq through selected export points. The inspectors were to monitor the amount of oil leaving Iraq under the Oil for Food program at these locations and to stop shipments if they found irregularities. The inspectors worked at two locations—the Ceyhan-Zakho pipeline between Iraq and Turkey and the Mina al-Bakr loading platform in southern Iraq. In 2005, a Saybolt official testified that Saybolt's mandate did not include monitoring all oil exports leaving Iraq from other locations

or acting as a police force.[16] As a result, the contractors did not monitor oil that was smuggled outside the Oil for Food program.

Further, because the Iraqi government did not install functioning oil meters at the port, inspectors could not accurately confirm the volume of oil loaded onto vessels. The lack of functioning meters enabled the Iraqi government to smuggle oil undetected by inspectors. A Saybolt employee testified that the company notified UN officials of the problems posed by the lack of functioning meters at the beginning of the program.[17] He also testified that the lack of metering equipment allowed the two "topping off" incidents involving the oil tanker Essex, in which the tanker loaded additional oil after the inspectors had certified the loading and left the vessel. In November 2001, a Saybolt representative noted that Iraq's distribution plans[18] provided for the installation of a meter at the Mina al-Bakr port, and a U.S. official called for OIP to develop a plan to prevent unauthorized oil sales that would include installing a meter at the port. However, Iraq did not tender a contract for the meter. As of March 2006, the Iraqi government had not yet installed oil meters at Mina al-Bakr.

In the absence of metering, Saybolt measured the onboard quantity of the vessel before loading. After loading, an inspector measured the amount by which the vessel tank fell short of being full and the oil temperature. Inspectors analyzed these data using the vessel's calibration chart to determine how much oil had been loaded onto the vessel. While this is an alternative method accepted in the inspection industry for situations in which reliable metering equipment is not available, a U.S. official noted that meters are a more consistent method for measuring oil loading and encouraged their incorporation into a plan for preventing unauthorized oil sales. The Saybolt representative also testified that this method was not as accurate or foolproof as using a meter.

In addition, the sanctions committee relied on the advice of independent oil overseers to approve oil sales contracts. The overseers reviewed Iraq's oil sales contracts to determine compliance with program requirements and whether the prices that Iraq negotiated for its oil were fair and

[16]Testimony of John Denson, General Counsel, Saybolt Group, before the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate (Washington, D.C.: Feb. 15, 2005).

[17]Ibid.

[18]For program phases IX and X—Dec. 6, 2000, through Nov. 30, 2001.

reflected market pricing. However, the inadequate number of overseers monitoring Iraq's oil pricing over a 14-month period may have been a factor in Iraq's ability to levy illicit surcharges on oil contracts. From June 1999 to August 2000, only one oil overseer was responsible for monitoring billions in Iraq's oil transactions, contrary to the sanctions committee's requirements for at least four overseers. Four overseers were hired at the beginning of the program but three had resigned by June 1999. Political disputes among sanctions committee members prevented the committee from agreeing on replacements. According to the Independent Inquiry Committee, the sanctions committee demonstrated weak program oversight in its inability to fill the vacant positions.

Retroactive Pricing Helped Limit Illicit Oil Surcharges

In October 2001, the Security Council's sanctions committee imposed a positive control activity—retroactive oil pricing—to prevent Iraqi officials from adding illegal oil surcharges to contracts. In November 2000, UN oil overseers reported that Iraq's oil prices were low and did not reflect the fair market value. The overseers also reported in December 2000 that Iraq had asked oil purchasers to pay surcharges. In early 2001, the United States informed the sanctions committee about its concerns regarding allegations that Iraqi government officials were receiving illegal surcharges on oil contracts. Because the committee operated by consensus, the United States could delay oil pricing by not approving a specific price per barrel until the oil was delivered to the refinery. The Iraq government thus signed contracts with suppliers without knowing the price it would have to pay until delivery. This practice, known as retroactive pricing, curbed the ability of the Iraqi government to levy illicit surcharges on its oil sales contracts. Prior to retroactive pricing, estimates of Iraq's illicit revenues from surcharges on exported oil ranged from about $230 million to almost $900 million.

Contract Examination Procedures Emphasized Dual-Use Items—Not Price and Value

According to a report by defense contract experts, in a typical contract pricing environment, fair and reasonable commodity prices are generally based on prevailing world market conditions or competitive bids among multiple suppliers.[19] Ensuring a fair and reasonable price for goods can mitigate the possibility of overpricing and kickbacks. The sanctions committee and OIP were responsible for reviewing commodity contracts under the Oil for Food program, but neither entity conducted sufficient

[19] *Report on the Pricing Evaluation of Contracts Awarded under the Iraq Oil for Food Program*, submitted by the Joint Defense Contract Audit Agency and Defense Contract Management Agency OFF Pricing Evaluation Team (Washington, D.C.: Sept. 12, 2003).

reviews of commodity pricing and value. As a result, Iraq was able to levy illicit commissions and kickbacks ranging from about $1.5 billion to about $3.5 billion.

The sanctions committee was responsible for screening contracts for items that could have military uses and for approving commodity contracts; any member had the authority to block or hold specific items. The committee focused on limiting Iraq's ability to import dual-use items rather than examining contracts for price and value. The United States, as a member of the sanctions committee, devoted resources to this contract oversight—about 60 staff from several U.S. government agencies reviewed the contracts for compliance with dual-use restrictions and made their recommendations to the U.S. mission to the UN. However, although the United States accounted for about 90 percent of the sanctions committee's holds, few contracts were held based solely on price and value concerns.

While OIP was to examine each contract for price and value before submitting it to the sanctions committee, the Independent Inquiry Committee found that OIP lacked clear authority to reject contracts on pricing grounds and did not hire customs experts with the requisite expertise to conduct thorough pricing evaluations. OIP stated that it informed the sanctions committee if it found pricing irregularities and that it was up to the sanctions committee to approve or hold contracts. However, the Independent Inquiry Committee found that few of the customs reports submitted to the sanctions committee included any quantitative or qualitative assessment beyond a general notation that pricing appeared high or was higher than in previous applications for similar goods. An OIP official also stated that OIP found that about 70 out of a total of approximately 30,000 contracts in the OIP database had specific price and value issues. OIP directly approved more than half of these 70 contracts as a result of Security Council decisions in 1999 and 2002 that shifted additional approval responsibilities to OIP. We did not have access to OIP's decisions to determine the extent to which OIP may have held contracts for price and value concerns.

Earlier Proposal for Price and Quality Review Was Not Included in Final Inspection Contract

The Secretariat's contract for inspecting humanitarian supplies at three entry points in Iraq required inspection agents to "authenticate" goods, but the agents' responsibilities fell short of a previous proposal to include more rigorous reviews of commodity price and quality. Under the Oil for Food program, inspection agents compared appropriate documentation, including UN approval letters, with the commodities arriving in Iraq; visually inspected about 7 to 10 percent of the goods; and tested food items to ensure that they were "fit for human consumption." However,

inspection agents were not required to (1) verify that food items were of the quality contracted, (2) assess the value of goods shipped, (3) interdict prohibited goods, (4) inspect goods that were not voluntarily presented by transporters, or (5) select the items and suppliers or negotiate contracts. According to Cotecna, the inspections contractor from 1999 to 2004,[20] "authentication" is not a standard customs term or function. The UN created the term for the Oil for Food program and did not include traditional customs inspection activities, such as price verification and quality inspection. In 1992, the UN selected Cotecna for a proposed program, which was not implemented, that would have been similar to the Oil for Food program. Under that proposal, Cotecna would have verified fair pricing and inspected whether the quality of the items conformed to contract requirements.

Program in Northern Iraq Had Inadequate Asset and Cash Management Controls

Control activities that ensure accountability include cash management policies and procedures that provide for physical control over vulnerable assets and other resources. OIOS and the Independent Inquiry Committee reported specific instances in which the UN offices involved in administering the Oil for Food program in northern Iraq lacked such controls. For example, in 2002, OIOS found that UN-Habitat lacked a proper asset inventory system and that no policies and procedures governing asset management were evident. In one case, $1.6 million in excess construction material remained after most projects were complete.

OIOS also reported that some funds were not used for the purpose intended, thus subjecting project funds misuse. In a March 2000 audit, OIOS reported that the UN Development Program country office used $500,000 in project funds for office expenses without authorization or proper documentation. A February 2002 audit found that the UN-Habitat office in Erbil put at risk $600,000 to $800,000 in cash due to a lack of cash management policies. In addition, the Independent Inquiry Committee reported thefts from several UN offices or persons, including $300,000 from the UN Educational, Scientific, and Cultural Organization's Erbil office; $64,000 from a World Health Organization suboffice; and $40,000 from the Food and Agricultural Organization when an automobile carrying more than $100,000 from Baghdad to Erbil was involved in an accident.

[20]The Coalition Provisional Authority used Cotecna from November 2003, when it assumed responsibility from the UN for remaining Oil for Food contracts, until October 2004, when the Iraqis no longer used independent inspection agents.

Poor Information and Communication Compromised Disclosure of Iraq's Illicit Revenue Schemes and Hindered UN Activities in Northern Iraq

Information should be communicated to those who need it within time frames that allow them to carry out their oversight responsibilities; however, OIP did not disclose to the sanctions committee all appropriate information that may have mitigated Iraq's ability to obtain illicit revenues, according to the Independent Inquiry Committee. For example, in December 2000, OIP's Program Management Division director informed the OIP director of alleged contract kickback schemes by the Iraqi government and recommended that OIP inform the sanctions committee of these allegations. The U.K. member of the sanctions committee asked for a written report of these allegations, but the Independent Inquiry Committee found no evidence that the report was submitted. In October 2001, OIP's customs chief—the person responsible for OIP's price and value reviews—prepared a written summary of the kickback incidents, including documentation of illicit side agreements with the Iraqi regime, and presented it to OIP senior management. However, the Independent Inquiry Committee found no evidence that this information was provided to the sanctions committee. Moreover, none of the Secretariat's 90-day or 180-day reports to the Security Council mentioned illicit payment demands in connection with oil or commodity contracts. Further, while both the Security Council and Secretariat were aware of smuggling activities outside of the program, OIP and the Secretariat had specific information from the Saybolt oil inspectors about the Syrian pipeline that was not disclosed to the sanctions committee.

In addition, poor communication and coordination among UN agencies in northern Iraq had a negative impact on some projects. In one instance, in 2004, OIOS reported that UN-Habitat had not adequately coordinated with other UN agencies in providing essential services for its housing projects. UN-Habitat provided high-capacity generators but had not contacted the UN Development Program—the entity responsible for the power sector—to provide electric power connections. In another instance, OIOS found that about 3,200 houses were unoccupied for extended periods due to a lack of coordination among agencies providing complementary services. The Independent Inquiry Committee's investigation also revealed problems with coordination among UN agencies, which was exacerbated by poorly defined relationships among those agencies, the Iraqi government, and the local authorities in the three northern governorates.

Monitoring Activities Did Not Ensure Adequate Internal Oversight

Monitoring is an internal control standard that assesses program performance on an ongoing basis and helps provide assurance that the findings of audits and other reviews are resolved. We identified monitoring weaknesses that compromised the Secretariat's internal oversight of the

program. While OIOS conducted numerous audits and identified hundreds of problems, it did not review OIP's oversight of the commodity contracts for central and southern Iraq. Nonetheless, its review of UN activities in northern Iraq led to more than 400 findings. Although OIP attempted to implement OIOS' recommendations, OIOS and the Independent Inquiry Committee reported that some systemic issues remained unresolved.

Limitations on OIOS Reporting and Resources Compromised Its Ability to Provide Effective Oversight

Although OIOS conducted more than 50 audits of the Oil for Food program and the separate compensation fund and identified more than 700 problems, the office did not review key aspects of the Oil for Food program and operated with low numbers of staff, given the program's size. Except for audits of OIP's inspection contracts, OIOS did not review whether OIP was adequately monitoring and coordinating the Oil for Food program, including OIP's role in assessing commodity pricing. OIOS did not examine certain headquarters functions, particularly OIP's oversight of the commodity contracts for central and southern Iraq, which accounted for 59 percent or almost $40 billion in Oil for Food proceeds. According to the Independent Inquiry Committee, OIOS believed that it did not have the authority to audit humanitarian contracts because the sanctions committee was responsible for their approval, and OIOS did not review OIP's relationship with the sanctions committee. In contrast, OIOS took an aggressive stance in reviewing UNCC decisions on compensation awards, despite the challenges to its authority from UNCC and the UN Office of Legal Affairs.

OIP management also steered OIOS toward program activities in northern Iraq rather than headquarters functions where OIP reviewed the humanitarian contracts. The Independent Inquiry Commission further noted that the practice of allowing the heads of programs the right to fund internal audit activities led to excluding high-risk areas from internal audit examination. We also found that UN funding arrangements constrain OIOS's ability to operate independently as mandated by the General Assembly and required the international auditing standards to which OIOS subscribes.[21] Because OIOS did not review commodity contracts, it was difficult to quantify the extent to which the Iraqi people received the humanitarian assistance funded by its government's oil sales.

[21]GAO, *United Nations: Funding Arrangements Impede Independence of Internal Auditors*, GAO-06-575 (Washington, D.C.: Apr. 25, 2006).

In addition, the number of OIOS staff assigned to the Oil for Food program was low compared with the level of staff providing oversight of peacekeeping operations, according to the Independent Inquiry Committee. Although OIOS had only 2 to 6 auditors assigned to cover the Oil for Food program. The UN Board of Auditors indicated that the UN needed 12 auditors for every $1 billion in expenditures. The committee concluded that the Oil for Food program should have had more than 160 auditors at its height in 2000. However, the committee found no instances in which OIOS communicated broad concerns about insufficient staff to UN management.

OIOS also encountered problems in its efforts to widen the distribution of its reporting beyond the head of the agency audited. In August 2000, OIOS proposed to send its reports to the Security Council. However, the OIP director opposed this proposal, stating that it would compromise the division of responsibility between internal and external audit. In addition, the UN Deputy Secretary General denied the request, and OIOS subsequently abandoned any efforts to report directly to the Security Council.

OIOS Found Numerous Problems in UN Management of Program in Northern Iraq, but Issues Were Not Fully Addressed

We did not have access to the internal audit reports conducted by eight of the nine agencies managing the program in northern Iraq. However, our February 2005 analysis of 25 OIOS audits on Oil for Food activities in northern Iraq identified about 430 problems in program management and monitoring and about 420 recommendations to correct these deficiencies.[22] In one instance, OIOS reported in 2004 that UN-Habitat had not adequately coordinated with other UN agencies in providing essential services for its housing projects. An August 2000 report noted a lack of planning that resulted in the questionable viability of some projects, including a health facility subject to flooding and diesel generators procured for an area in which diesel fuel was not readily available. In November 2002, OIOS reported that almost $38 million in equipment procurement was not based on a needs assessment—resulting in 51 generators not being used from September 2000 to March 2002—and that 11 purchase orders totaling almost $14 million showed no documentary evidence supporting the requisitions. In April 2002, OIOS reported that OIP and UNOHCI had made serious efforts to implement audit recommendations. However, it also noted that a number of issues had not been resolved, including efforts to improve the procurement, planning, coordination, and monitoring of

[22] GAO-05-346T.

projects in northern Iraq. The Independent Inquiry Committee also found that a lack of attention to addressing systemic problems hindered the effectiveness of the Oil for Food program in the north. The recurring nature of these problems over the course of the program demonstrated that systemic weaknesses were not fully addressed.

UNCC Has Paid More than $20 Billion in Compensation Claims, but Remaining Payments of More than $32 Billion May Take until 2020

The UN Security Council established UNCC in 1991 under Security Council Resolution 692 to process claims and pay compensation for damages and losses resulting from Iraq's invasion and subsequent occupation of Kuwait. UNCC is a subsidiary organ of the UN Security Council, with its Governing Council acting as the policy-making body. With the adoption of Security Council resolution 986, UNCC, along with UN-sponsored humanitarian programs in Iraq, received funding from the profits from Iraqi oil sales. (App. IV provides more information on the organization of UNCC and its claims process.)

UNCC approved awards of almost $52.5 billion to more than 1.5 million claimants and, as of January 2006, had paid about $20.3 billion of this amount. However, how and when the remaining approximately $32.2 billion in approved claims will be paid is uncertain. Depending on the growth of Iraq's oil export revenues, award payments may be completed sometime between 2017 and 2020. These unpaid claims are in addition to Iraq's external debt to international creditors, which the International Monetary Fund (IMF) estimated at $51 billion at the end of 2005. UNCC's Secretariat had controls for preparing claims for presentation to the expert panels, who then recommended which claims should be paid and the amounts to be compensated. However, OIOS found some weaknesses in UNCC's oversight of procedures for returning unclaimed payments and instances of claims overpayments by the panels recommending the awards. For example, in May 2005, OIOS reported that governments and international organizations owed UNCC about $38.8 million in claims that it was unable to pay because claimants could not be located. According to UNCC, the total amount owed to the UNCC as of March 2006 was $11.7 million.

Almost $32.2 Billion in Unpaid Awards Increases Iraq's Debt Burden and May Not Be Paid Until 2020

From 1991 to 1997—its deadline for accepting claims—UNCC received almost 2.7 million claims seeking almost $353 billion in compensation for damages and losses.[23] UNCC required that claimants submit claims through their governments and also allowed international organizations to submit claims on their behalf or on behalf of individuals who were not in a position to have a government file their claims. Individual claims came from Kuwaitis and also from many of the roughly two and a half million expatriate workers and their dependents living in Kuwait and Iraq at the time of the invasion, 90 percent of whom fled the region due to the war. As a result, UNCC received claims from 100 countries on behalf of the country submitting the claim, its nationals, or its corporations. Upon completing its work in 2005, UNCC had awarded more than 1.5 million claimants almost $52.5 billion in compensation, almost 15 percent of the total amount sought. OIOS auditors stated that an award rate of 15 percent is low and is evidence of the UNCC's conservative approach to making awards. Appendix IV provides greater detail on the categories and amounts of claims.

As of late January 2006, UNCC had paid about $20.3 billion in compensation of the $52.5 billion awarded, mostly to individuals and families. About $32.2 billion in outstanding awards remains to be paid. Depending on the growth of Iraq's oil revenue, payments could extend through around 2020. In 2003, Security Council resolution 1483 reduced the portion of Iraqi oil revenues allotted to UNCC from 25 percent to 5 percent.[24] Using projections made by the International Monetary Fund, we estimate that the remaining compensation awards could be paid between 2017 and 2020, assuming that oil export revenues grow at an annual average rate of about 5 percent and are about 57 percent of gross domestic product. With an average growth rate of 1 percent, the remaining compensation awards would be paid by 2020. At 10 percent, these awards

[23]UNCC accepted a number of claims filed after the February 1997 deadline from groups that were unable to meet the deadline. For example, UNCC accepted around 32,000 late claims from Bedouns—members of a community that lived in Kuwait for many years but were not citizens of Kuwait or any other nation—almost 10 years after the deadline. The claims were late because no country or international organization had accepted responsibility for filing the claims. UNCC also continues to receive a small number of claims forwarded on behalf of missing persons as well as claims for damages and losses resulting from land mines but will no longer accept these claims after 2006.

[24]With the adoption of Security Council resolution 986 in 1995, UNCC was directed to receive up to 30 percent of the proceeds of Iraq's oil sales. This amount was reduced to 25 percent in December 2000 pursuant to resolution 1330.

would be paid by 2017.[25] These unpaid claims are in addition to Iraq's substantial external debt. In January 2006, the IMF estimated Iraq's debt at the end of 2005 at about $51 billion.

With the conclusion of the award process in 2005, UNCC's Secretariat completed its claims preparation duties and began reducing its staff. The UNCC secretariat expects that by mid-2007 the payment of all individual awards will be completed. As an interim measure after that time, the Governing Council will oversee the Compensation Fund with assistance from a smaller secretariat. The Governing Council will consider a future date for transferring responsibility for remaining payments to the Iraqi government under the supervision of the Security Council.

UNCC Had Controls for Claims Preparation, but OIOS Reported Concerns with Award Payment Procedures

The UNCC secretariat employed controls in its administrative procedures for preparing claims for the expert panels, but OIOS found some weaknesses in the procedures for ensuring that unpaid claims are returned to UNCC and instances of claims overpayments. OIOS found that inadequate oversight of the procedures for paying awarded amounts to claimants resulted in governments and international organizations owing UNCC about $38.8 million in unclaimed payments. In its response to a draft of this report, UNCC noted that this amount totaled $11.7 million as of March 2006. Further, OIOS noted that only about half of these entities had submitted required audit documents certifying their payments to claimants. UNCC responded that the overwhelming majority of awards had been successfully paid and that it was working with five of these governments to improve their reporting obligations. UNCC questioned OIOS' authority to audit certain aspects of its work, and a UN legal opinion agreed with UNCC, stating that the scope of OIOS' audit authority did not extend to those parts of UNCC's work that constituted a legal process. Nonetheless, OIOS identified more than $500 million in potential overpayments to claimants.

UNCC Secretariat Had Controls for Processing Claims

The claims award process was handled by three UNCC entities: the Secretariat, the Governing Council, and the Commissioner panels. The Secretariat organized the claims, prepared them for review by the Commissioner panels, and administered the award payments to

[25]See *Iraq: Request for Stand-By Arrangement*. We used data from IMF and an economic consulting firm in calculating our scenarios. Appendix I contains details on our methodology.

governments and international organizations submitting the claims on behalf of claimants. The Commissioner panels reviewed the claims, made recommendations to reject or accept the claims, and recommended award amounts. The Governing Council made final award decisions based on the panels' recommendations. The council could disagree with the recommendations and return the decisions to the panels for further review; it could also increase or reduce the award amounts. After award decisions were final, payments were made to governments and international organizations submitting claims, and these entities distributed award payments to individual claimants.

In managing the steps required to prepare claims for presentation to the Commissioner panels, the Secretariat put in place various measures to mitigate administrative errors and fraud, including efforts to ensure the integrity of claims data, identify duplicate claims, and deliver preliminary claims valuations to the Commissioner panels. For example, the Secretariat's process included assigning all incoming claims a unique number, running quality control checks, and cleaning up queries to ensure the integrity of the data entered under each number. A 2002 assessment conducted by OIOS stated that certain controls for processing claims and the claims database were generally adequate at that time.

OIOS Reported Concerns with Award Payments, but UNCC Challenged OIOS's Authority to Audit Specific Aspects of UNCC's Work

OIOS concluded in May 2005 that UNCC did not exercise adequate oversight over the distribution of award payments by governments and international organizations. UNCC requires governments and organizations to report on the amount of payments distributed and the reasons for nonpayment of claims 12 months following the release of award payments. All funds not located and paid are to be returned to UNCC within this 12-month period.[26] OIOS reported that the Secretariat did not properly review reports from governments detailing which awardees could not be located. The auditors also reported that governments and international organizations owed UNCC about $38.8 million in compensation intended for claimants they were unable to locate (governments and organizations did refund about $99 million to UNCC). Of this amount, more than $4 million had been outstanding for more than 2 years.[27] In addition, OIOS found that 14 of the 32 governments and international organizations receiving a total of about $197 million in an

[26]Governing Council Decisions 18 and 48.

[27]Of the 3,126 U.S. claimants receiving UNCC awards, 29 have not been located. The United States has returned about $100,000 to UNCC.

October 2003 disbursement of award payments had not submitted an audit certificate documenting that payments had been distributed. The uncertified amount totaled about $156 million.

In comments to OIOS dated June 2005, UNCC responded that the overwhelming majority of the awards were successfully paid and that UNCC strongly pursued the submission of audit certificates by governments and international organizations. UNCC also commented that it had visited five countries to assist governments with their reporting obligations and payment distribution. UNCC further noted that it is the responsibility of the governments and organizations to locate claimants for payment but added that it would review the actions necessary to obtain a full accounting from governments that failed to meet prescribed deadlines. In addition, in commenting on a draft of this report, UNCC noted that the amount owed to UNCC can fluctuate almost daily as governments and international organizations locate previously unreachable claimants and ask for funds for repayment. UNCC further noted that audit certificates were required for payments beginning in October 2003. In responding to our draft report, UNCC provided updated documentation demonstrating that, as of March 2006, the amount owed to UNCC had decreased to $11.7 million, and only $1.5 million—or 0.8 percent of the $197 million for which certificates were due—had not been supported by audit certificates.

UNCC challenged OIOS's authority to review specific aspects of UNCC's work and requested guidance from the UN Office of Legal Affairs. Specifically, UNCC questioned whether OIOS had the authority to review (1) the Panel's work in identifying applicable law and the Panel's application of that law to claims pursuant to the UNCC's Provisional Rules for Claims Procedure; (2) the manner in which the Panel organized its work pursuant to those Rules; and (3) the Panel's determinations regarding the sufficiency of evidence, including its determinations relating to the relevance, materiality, and weight of evidence pursuant to UNCC's rules. In 2002, UN legal counsel rendered an opinion, stating that the audit authority of OIOS included reviewing the panels' computations of its recommended compensation amounts but did not extend to reviewing those aspects of the panels' work that were part of the legal process. The UN legal counsel concluded that all three aspects of the Panel's work in question were beyond the proper scope of OIOS's audit authority. Both UNCC and the Department of State agreed with the UN legal opinion. OIOS disputed it, however, noting its general mandate to review and appraise the use of UN financial resources. In response, UNCC argued that the compensation fund does not constitute UN financial resources. As a result, UNCC only acted on those OIOS recommendations that it

determined, consistent with the UN legal counsel's opinion, were within the scope of its audit authority.

OIOS continued to report on claims amounts and identified more than $500 million in recommended claims reductions. For example, in a September 2002 audit, OIOS found potential overpayments of $419 million in compensation awarded to Kuwait due to duplicate payments, calculation errors, insufficient evidence to support losses, and inconsistent claims methodologies. In April 2003, UNCC provided a detailed response to OIOS. In its response, UNCC cited documentation which they said showed that there were no duplicate payments and provided additional evidence of the losses—consultant reports, additional documentation, and testimony. UNCC also stated that it and not OIOS had authority to determine the sufficiency of evidence—for example, using testimonial evidence with other support when documentary evidence was destroyed during Iraq's invasion of Kuwait. As of February 2005, UNCC had agreed to reduce total claims overpayments by about $3.3 million.

Conclusion

The Oil for Food program was flawed from the outset because it did not have sufficient controls to prevent the former Iraqi regime from manipulating the program. Internal controls, if properly designed and implemented, can provide reasonable—although never absolute—assurance that program goals will be met and fraud will be minimized. Despite the risks inherent in allowing Iraqi government control over the contracting process and expanding the program beyond its initial emergency mandate, the Security Council and the Secretariat did not establish a system of internal controls, including timely and comprehensive risk assessment and effective control activities and monitoring. Moreover, fragmentation of responsibilities led to an environment in which no single unit or person was accountable for program management, monitoring, and oversight. The Oil for Food program was arguably the largest sanctions and humanitarian program in its scope, complexity, and structure that the UN had undertaken. Given the enormity of the undertaking, internationally accepted internal control standards should have been applied throughout the course of the program. Such standards would have helped ensure that the program was effectively and efficiently managed and that the Iraqi people received the intended benefits from the proceeds of its government's oil sales.

U.S. oversight of the Oil for Food program focused on preventing Iraq from obtaining dual-use items that could be used for military and weapons of mass destruction programs while meeting the humanitarian needs of

those suffering from sanctions. However, the United States and other Security Council members did not apply the same rigor to preventing Iraq from obtaining illicit funds through smuggling and contract kickbacks. Over the past several years, the United States has taken the lead in promoting management and oversight reform at the UN. The lessons learned from the internal control weaknesses in the Oil for Food program could prove useful as the United States continues to press the UN to undertake fundamental reforms to address its key efficiency, management, and accountability challenges.

Recommendation for Executive Action

We recommend that the Secretary of State and the Permanent Representative of the United States to the UN work with other member states to encourage the Secretary General to take the following two actions:

- ensure that UN programs with considerable financial risk establish, apply, and enforce the principles of internationally accepted internal control standards, with particular attention to comprehensive and timely risk assessments and
- strengthen internal controls throughout the UN system based in part on the lessons learned from the Oil for Food program.

Agency Comments and Our Evaluation

We provided a draft of this report to the Secretary of State, the UN Deputy Secretary General, and the UN Compensation Commission for comment. We received written responses from State and UNCC (see apps. V and VI for the comments and our complete response). State did not agree or disagree with our recommendation but commented that, although no sanctions regime similar to Oil for Food is in place, tighter internal controls would be appropriate for a future program similar to Oil for Food. We have modified our recommendation to clarify that the principals of oversight and control should apply not just to programs with the unique characteristics of Oil for Food. The UN concurred with our recommendations and noted that it is taking steps to strengthen internal control in the organization. The UN also provided technical comments, which we have incorporated into the report as appropriate.

State commented that our report does not (1) clearly distinguish between the responsibilities and actions of the Secretary General and the Security Council, (2) overstates the case that diffusion of responsibility for the program meant that no single entity was in charge and accountable for the

program, (3) does not highlight the Security Council's inaction in the face of corruption in the sanctions regime, and (4) overstates the importance of internal control.

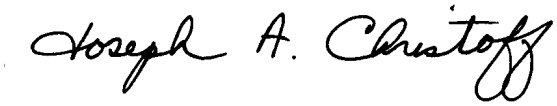
We disagree. First, our report clearly distinguishes between the responsibilities and actions of the Secretary General and the Security Council. We note that both had a role in the decision to give Iraq contract authority; the Secretary General negotiated the agreement and the Security Council approved it. Second, the diffusion of program responsibilities was a major structural weakness of the program. Although the Secretary General was responsible for program management, the Security Council made key decisions about commodity contracts and oil pricing, and nine UN agencies administered the program in the North. Third, our report highlights inaction by the Security Council by fully discussing, for example, its inaction on oil smuggling to neighboring states. Finally, we believe that State does not sufficiently emphasize the importance of internal controls for a vulnerable program. Internationally accepted controls require an overall structure of accountability with clear lines of authority and a comprehensive risk assessment. Taking these actions could have mitigated some of the corruption in the Oil for Food program.

UNCC commented that we should not include UNCC as part of a report that deals with lessons learned from the Oil for Food program. UNCC requested that we issue a separate report or distinct chapter on its organization with additional information about its organization. We included UNCC in this report because it received more than $20 billion in Iraqi oil revenues under resolution 986; our intent is to report fully on the entities entrusted with management of this revenue. We have modified the report to further make it clear that UNCC is not part of the Oil for Food program and that it is a separate entity funded by Iraqi oil revenues. UNCC further commented that it provided OIOS with comprehensive responses to audit findings of potential overpayments of compensation but that our draft report did not adequately discuss these formal responses. In addition, UNCC stated that our discussion of OIOS's legal authority to audit UNCC awards does not adequately describe the position of UNCC or the UN General Counsel's legal opinion. We added information to the report to describe UNCC responses to OIOS recommendations and its position regarding OIOS's legal authority to audit its activities.

We are providing copies of this report to the Secretary of State and interested congressional committees. We will also make copies available

to others upon request. In addition, the report will be available on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-8970 or ChristoffJ@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix VII.



Joseph A. Christoff, Director
International Affairs and Trade

Congressional Committees:

The Honorable John Warner
Chairman
The Honorable Carl Levin
Ranking Minority Member
Committee on Armed Services
United States Senate

The Honorable Duncan L. Hunter
Chairman
The Honorable Ike Skelton
Ranking Minority Member
Committee on Armed Services
House of Representatives

The Honorable Richard G. Lugar
Chairman
The Honorable Joseph R. Biden, Jr.
Ranking Minority Member
Committee on Foreign Relations
United States Senate

The Honorable Henry J. Hyde
Chairman
The Honorable Tom Lantos
Ranking Minority Member
Committee on International Relations
House of Representatives

The Honorable Susan M. Collins
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The Honorable Joseph I. Lieberman
Ranking Minority Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Tom Davis
Chairman
The Honorable Henry A. Waxman
Ranking Minority Member
Committee on Government Reform
House of Representatives

Appendix I: Scope and Methodology

To assess aspects of the control environment of the Oil for Food program, we collected and analyzed (1) our prior reports and testimonies on the Iraq sanctions and Oil for Food program, (2) reports issued by the United Nations (UN) Independent Inquiry Committee and the Iraq Survey Group, (3) UN Office of the Iraq Program (OIP) documents, (4) relevant Security Council resolutions and the memorandum of understanding between the UN and the Iraqi government, (5) UN Secretariat reports to the Security Council, and (6) summaries of meetings of the Security Council's Iraq sanctions committee. We reviewed Security Council reports and documents related to oil smuggling to neighboring countries.

To assess the sanctions and Oil for Food Program in relation to the four other internal control standards, we collected and analyzed the documentation listed above and also reviewed reports of the UN Office of Internal Oversight Services (OIOS) and other entities. The UN General Assembly created OIOS in 1994 and tasked it with conducting audits, investigations, inspections, and evaluations of UN programs and funds. The internal audit divisions of OIOS adhere to the Standards for the Professional Practice of Internal Auditing in the UN.[1] In February 2005, we catalogued the findings and recommendations of 50 OIOS reports to determine common themes related to the management of the Oil for Food program and UN Compensation Commission (UNCC) using a protocol to identify findings for data input. To ensure consistency of data input, a database manager reviewed all input, and all input was independently validated. At the State Department's Oil for Food reading room, we reviewed more than 600 documents, including cables, reports, and memoranda. We asked for copies of these documents; we received about 250 of them. We also reviewed summaries of internal audits provided by the UN Development Program. Based on our review of these summaries and references to agencies' internal audits in Independent Inquiry Committee reports, we determined that the basic issues raised in these reports mirrored many of the findings and recommendations of the OIOS reports.

We also met with officials responsible for implementing and overseeing the sanctions and Oil for Food program to discuss the internal controls used in the program. These officials included representatives from the Departments of Commerce, Defense, Treasury, and State. We traveled to

[1]As promulgated by the Institute of Internal Auditors and adopted by the Representatives of Internal Audit Services of the UN Organizations and Multilateral Financial Institutions.

New York to meet with officials from the U.S. Permanent Mission to the UN in New York, OIP, OIOS, the UN Children's Fund, the UN Development Program, and the UN Office for Project Support. We also met with representatives from the Independent Inquiry Committee and the Iraq Survey Group to discuss their report findings and methodologies. To assess both the control environment and the other internal control standards, we applied the internal control standards described in GAO's Standards for Internal Control in the Federal Government.[2]

We used the following methodology to estimate the former Iraqi regime's illicit revenues from oil smuggling, surcharges on oil, and commissions from commodity contracts from 1997 through 2002:

- To estimate the amount of oil the Iraqi regime smuggled, we used Energy Information Administration (EIA) estimates of Iraqi oil production and subtracted oil sold under the Oil for Food program and domestic consumption. The remaining oil was smuggled through Turkey, the Persian Gulf, Jordan, and Syria (oil smuggling to Syria began in late 2000).

- We estimated the amount of oil to each destination based on information from and discussions with officials of EIA, Cambridge Energy Research Associates, the Middle East Economic Survey, and the private consulting firm Petroleum Finance.

- We used the price of oil sold to estimate the proceeds from smuggled oil. We discounted the price by 9 percent for the difference in quality. We discounted this price by 67 percent for smuggling to Jordan and by 33 percent for smuggling through Turkey, the Persian Gulf, and Syria. According to oil industry experts, this is representative of the prices paid for smuggled oil.

- To estimate the amount Iraq earned from surcharges on oil, we multiplied the barrels of oil sold under the Oil for Food program from 1997 through 2002 by 25 cents per barrel. According to Security Council members, the surcharge varied, but Iraq tried to get as much as 50 cents per barrel. Industry experts also stated the surcharge varied.

- To estimate the commission from commodities, we multiplied Iraq's letters of credit for commodity purchases by 5 percent for 1997 through 1998 and

[2]GAO/AIMD-00-21.3.1. We also referred to GAO's publication, *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: August 2001).

10 percent for 1999 through 2002. According to Security Council members, the commission varied from 5 percent to 10 percent. This percentage was also confirmed in interviews conducted by U.S. officials with former Iraqi regime ministers of oil, finance, and trade and with Sadaam Hussein's presidential advisors.

We did not obtain source documents and records from the former regime about its smuggling, surcharges, and commissions. Our estimate of illicit revenues is therefore not a precise accounting number. Areas of uncertainty in our estimate include:

- Our estimate of the revenue from smuggled oil is less than the estimates of U.S. intelligence agencies. We used estimates of Iraqi oil production and domestic consumption for our calculations. U.S. intelligence agencies used other methods to estimate smuggling.

- Our estimate of revenue from oil surcharges is based on a surcharge of 25 cents per barrel from 1997 through 2002. However, the average surcharge could be lower. UN Security Council members and oil industry sources do not know when the surcharge began or ended or the precise amount of the surcharge. One oil industry expert stated that the surcharge was imposed at the beginning of the program but that the amount varied. Security Council members and the U.S. Treasury Department reported that surcharges ranged from 10 cents to 50 cents per barrel. As a test of reasonableness, we compared the price paid for oil under the Oil for Food program with a proxy oil price for the period 1997 through 2002. We found that for the entire period, the price of Iraqi oil was considerably below the proxy price. Oil purchasers would have to pay below market price to have a margin to pay the surcharge.

- Our estimate of the commission on commodities could be understated. We calculated commissions based on the commodity contracts for the 15 governorates in central and southern Iraq (known as the "59-percent account" because these governorates received this percentage of Oil for Food revenues). We excluded contracts for the three northern governorates (known as the "13-percent account"). However, the former Iraqi regime negotiated the food and medical contracts for the northern governorates, and the Defense Contract Audit Agency found that some of these contracts were potentially overpriced. The Defense Contract Audit Agency also found extra fees of between 10 and 20 percent on some contracts.

To examine the progress and procedures of UNCC, we reviewed its publicly available information, including extensive background

information, a literature review, and copies of all official documentation pertaining to Governing Council policy decisions, panel recommendations, and disbursement figures. To gather information about UNCC's management of its claims process, we reviewed about 20 OIOS audit reports related to the UNCC's activities and met with attorneys from the Department of State regarding the U.S. role in adjudicating and delivery claims payments. In July of 2005, we visited the UNCC headquarters in Geneva, Switzerland, where we met with UNCC officials and the U.S. representative to the Governing Council regarding the procedures for administering the claims review and award processes. At that time, we obtained and reviewed written information on all steps for the claims processes undertaken by the UNCC Secretariat. We also met with OIOS auditors that conducted reviews of UNCC's claims files, award decisions, and internal controls for the UNCC Secretariat's claims procedures. We verified the most recent figures related to claims received, awarded, and disbursed with officials in Geneva and Washington. We determined that UNCC data on claims are sufficiently reliable to report the aggregate amount of claims awarded, the claims that UNCC has paid on behalf of Iraq, and the claims that Iraq still owes.

To determine figures relating to Iraq's ability to pay off remaining compensation awards, we developed an analysis built on International Monetary Fund (IMF) projections of Iraqi crude oil export revenue, award payment, and nominal gross domestic product (GDP), in both dollars and Iraqi dinars, for the period 2006 through 2010.[3] We converted estimated crude oil export revenue and award payments into dollars. We projected annual crude oil export revenue for the period 2011 through 2025 by assuming a constant annual growth rate. For each scenario, we selected a constant growth rate such that the annual average growth rate during 2006 through 2025 would be 10, 5, or 1 percent, respectively. We estimated annual award payments as 5 percent of annual crude oil export revenue. For each scenario, we computed cumulative award payments commencing in 2006 until the total exceeded $32.5 billion,[4] the outstanding award balance as of January 2006. We noted the year in which this occurred for each scenario.

[3]IMF, *Iraq: Request for Stand-By Arrangement*, (Washington, D.C.: Dec. 7, 2005).

[4]At the time of our calculations, remaining unpaid awards totaled about $32.5 billion; by late January 2006 that amount had been reduced to about $32.2 billion.

To calculate the ratio of crude oil export revenue to GDP, we projected annual Iraqi GDP during 2011 through 2025. Using nominal GDP projections from the economic consulting firm Global Insight,[5] we computed annual growth rates of nominal dollar GDP for the years 2011 through 2025. We applied these growth rates to the IMF-projected 2010 GDP figure and computed annual GDP through 2025. We constructed the ratio of crude oil export revenue to GDP for each scenario and calculated the average ratio for the period 2006 through 2025.

We used the IMF report as the basis for our projections of how long it might take Iraq to repay the UNCC-awarded compensation because the report is the basis for approving the Stand-By Arrangement for Iraq of (Special Drawing Rights) SDR 475.4 million (about $685 million), which is intended to stabilize Iraq's economy. Further, the IMF stand-by arrangement triggers a further reduction of 30 percent of Iraq's sovereign debt, as agreed to by international creditors.

[5]Global Insight, *International Interim Forecast Analysis*, *Country Tables-Iraq* (Boston, MA: Jan. 6, 2006).

Appendix II: Oil for Food Program Processes

This appendix briefly summarizes the extensive and complicated processes of the Oil for Food program. Under the program, the UN Security Council's Iraq sanctions committee approved the contracts negotiated by Iraq for selling its oil. After oil was shipped, the companies deposited the funds into a UN-held account, and the proceeds from this account were used to fund humanitarian goods and services for Iraq. The Iraqi government negotiated the commodities for the 15 central and southern governorates under its control, as well as food and medicine for the entire country, including the three autonomous Kurdish governorates in northern Iraq. The UN reviewed and approved contracts to ensure that no items with potential military use were imported by Iraq with the program's funds. The Iraqi government distributed the goods within the central and southern governorates. In northern Iraq, UN agencies distributed the food and medicine procured by the Iraqi government and contracted goods and services to implement humanitarian assistance projects in several sectors.

Oil Sales

Iraq's state-owned oil marketing company was responsible for negotiating contracts with international oil companies to sell Iraqi oil. Once negotiated, the oil purchase contracts were reviewed by a panel of contracted oil overseers reporting to the Security Council's Iraq sanctions committee. The oil overseers also reviewed Iraq's pricing proposals and advised the sanctions committee on fair pricing. The sanctions committee used the advice of the overseers to set the oil price and approve contracts. The Secretariat also contracted oil inspectors to monitor and inspect the quantity of the oil exported. Once the oil was shipped, the oil purchasers directly deposited the proceeds into a UN-monitored escrow account held at the New York branch of France's Banque Nationale de Paris (BNP, now BNP-Paribas).[1]

Humanitarian Assistance to Central and Southern Iraq

The Iraqi government used the proceeds from its oil sales to purchase food, medicines, and infrastructure supplies and equipment. The government first submitted a distribution plan to the UN Secretariat for all 18 governorates and then negotiated contracts directly with suppliers for

[1]In response to auditors' concerns that too much money was being concentrated at BNP, the number of banks receiving Oil for Food deposits was expanded after 2000 to include JP Morgan Chase, Deutsche Bank, Banco Bilbao Vizcaya, Credit Agricole Indosuez, Credit Suisse, and HypoVereinsbank.

goods for central and southern Iraq.[2] OIP reviewed contracts submitted by suppliers to ensure that the paperwork was complete and submitted it to the sanctions committee for approval. Beginning in December 1999, resolution 1284 abolished Iraq's export ceiling to purchase civilian goods, and the Security Council authorized OIP to approve certain humanitarian items without committee approval.

Before May 2002, all exports to Iraq were forbidden unless the Security Council specifically permitted them through resolutions or decisions. Starting in May 2002, in accordance with Security Council resolution 1409, the Security Council introduced a new system under which all goods were permitted, except products that could be used to develop weapons of mass destruction, conventional weapons, and military-related or dual-use goods. These controlled items were specifically listed on what was known as the goods review list, and only these items were referred to the sanctions committee for review. Two UN inspection bodies assigned to monitor Iraq's military and weapons of mass destruction programs—the UN Monitoring, Verification, and Inspection Committee and the International Atomic Energy Agency—examined commodity contracts to see if they contained items on the goods review list. Items that were on the goods review list, not entire contracts, were forwarded to the sanctions committee for further review and either approval or denial.

Each member of the Iraq sanctions committee had authority to approve, hold, or block any contract; and the United States, as an active member of the sanctions committee, conducted a review of each commodity contract. U.S. technical experts assessed each item in a contract to determine its potential military application and whether the item was appropriate for the intended end user. These experts also examined the end user's track record with such commodities. An estimated 60 U.S. government personnel within the Departments of State, Defense, Energy, and other agencies examined all proposed sales of items that could be used to assist the Iraqi military or develop weapons of mass destruction. In addition, the Department of the Treasury was responsible for issuing U.S. export licenses to Iraq. It compiled the results of the review by U.S. agencies under the UN approval process and obtained input from the Department of Commerce on whether a contract included any items found on a list of

[2]In accordance with the 1996 memorandum of understanding, the Iraqi government purchased food and medicines in bulk, including food and medicine intended for the three northern Kurdish governorates.

goods prohibited for export to Iraq for reasons of national security or nuclear, chemical, and biological weapons proliferation.

When a contract was approved, the government of Iraq requested a letter of credit for the supplier. UN contractors at entry points into Iraq authenticated shipments. Following the authentication, OIP authorized the bank to pay the supplier from the escrow account. The Iraqi government was then responsible for distributing the items in accordance with the distribution plan and with its Public Distribution System, a food ration basket for all Iraqis. Commodity distribution in Iraq was monitored by about 160 UN observers who visited ration centers, marketplaces, warehouses, and other installations to ensure that distribution was equitable and in accordance with the targeted allocation plans submitted by Iraq for each 6-month phase.

Humanitarian Assistance to Northern Iraq

The Oil for Food program in the three semiautonomous governorates in northern Iraq was managed separately to ensure that these regions, with a majority Kurdish population, received the humanitarian assistance needed. Security Council resolution 986 and the 1996 memorandum of understanding between Iraq and the UN created a framework under which nine UN agencies delivered emergency assistance and humanitarian aid in these regions. The process for delivering humanitarian assistance varied from that in central and southern Iraq. Food and medicines were procured in bulk by the central Iraqi government, and UN workers, accompanied by UN security guards, monitored the distribution of these items in the northern region. Activities of the nine UN agencies included constructing or rehabilitating schools, health clinics, power generation facilities, and houses.

Appendix III: Estimates and Ranges of Iraq's Illicit Revenues and Payments during the Oil for Food Program

GAO, the Iraq Survey Group, and the Independent Inquiry Committee each estimated the illicit revenues and payments obtained by the Iraq regime through its surcharges on oil sales, questionable commissions and kickbacks on commodity contracts, and smuggling. In their published estimates, the Iraq Survey Group and the Independent Inquiry Committee included revenues from smuggling and other trade outside the Oil for Food program since 1991, when sanctions were first imposed. We have included only their estimates for the years of the Oil for Food program—from 1997 through about early 2003. our estimates include revenues from 1997 through the end of 2002. (App. I contains more detail on our methodologies for estimating Iraq's illicit revenues.)

Table 1: Estimates of Iraq's Illicit Revenues during the Period of the Oil for Food Program, by Source

U.S. dollars in millions

Revenue type	GAO	Iraq Survey Group[a]	Independent Inquiry Committee
Surcharges on oil sales	0.9	0.23	0.23
Commodity purchase kickbacks	3.5	1.5	1.6
Smuggling/trade outside program	5.7	6.8	8.4
Total	**10.1**	**8.53**	**10.23**

Source: For GAO estimates: analysis of data from the oil industry, the Department of Energy, and information from Security Council member states. For other estimates: GAO analysis of Iraq Survey Group and Independent Inquiry Committee data.

[a]The Iraq Survey Group was created in 2003 to investigate Iraq's weapons of mass destruction program. It included analysts from the Central Intelligence Agency, Defense Intelligence Agency, the Departments of Energy and State, and from allied countries. It reported its findings in an unclassified report, *Comprehensive Report of the Special Advisor to the DCI on Iraq's WMD* (Sept. 30, 2004).

Table 2: Ranges of Iraq's Illicit Revenues during the Oil for Food Program

U.S. dollars in millions

Revenue type	Lowest estimate	Highest estimate
Surcharges on oil sales	0.23	0.9
Commodity purchase kickbacks	1.5	3.5
Smuggling/trade outside program	5.7	8.4
Total	**7.43**	**12.8**

Source: GAO analysis of estimates developed by GAO, the Iraq Survey Group, and the Independent Inquiry Committee.

Illicit Surcharges on Exported Oil

For oil surcharges, we multiplied barrels of oil sold under the Oil for Food program for 1997 through 2002 by 25 cents, based on estimates supplied by

Security Council members and oil industry experts. The Iraq Survey Group had access to records at Iraq's State Oil Marketing Organization (SOMO) and to U.S. interviews with former Iraqi officials. It based its surcharge estimates on the organization's collections for 2000 through 2002. The Independent Inquiry Committee adopted a similar methodology using Iraqi records.

Commodity Purchase Kickbacks

We multiplied letters of credit for purchases by 5 percent for 1997 through 1998 and by 10 percent for 1999 through 2002. We based this methodology on interviews with Security Council members that illicit commissions varied from 5 to 10 percent. This information was subsequently confirmed by former Iraqi minister and Saddam Hussein's advisors in interviews conducted by U.S. officials.

The Iraq Survey Group included estimates for the period 2000 through early 2003. It developed a formula based on Iraq's oil earnings, the actual amounts spent on imports, lags between earnings and contract signings, and an estimated 10-percent kickback.

The Independent Inquiry Committee's estimate was based on UN accounting records detailing the actual amounts spent on Oil for Food contracts, Iraqi records that set forth the regime's policies on obtaining illicit income, Iraqi ministry records with data on the kickbacks levied and collected, and banking records confirming and quantifying the deposit of kickbacks into collection accounts.

Smuggling and Trade-Related Revenues

To determine the amount of oil smuggled, we subtracted the amounts of oil sold through the Oil for Food program and domestic consumption from Iraq's production for 1997 through 2002 (as determined by the U.S. Department of Energy). We estimated illicit proceeds from this oil using prices for Iraqi oil under the Oil for Food program and price discounting methods. On the basis of discussions with experts, we applied a discount rate of between one-third to two-thirds of the Oil for Food price to the smuggled shipments, depending on location.

The Iraq Survey Group separated earnings from ongoing trade agreements with neighboring countries from "private sector" oil revenue obtained outside either the Oil for Food program or ongoing trade agreements. For revenue from trade agreements, the Iraq Survey Group primarily used SOMO information on its invoices and collections from under these agreements. For "private sector" revenues during the Oil for Food program

period, it relied mostly on SOMO actual collections for cash transactions and the invoice value for barter trade.

Similar to the Iraq Survey Group, the Independent Inquiry Committee broke out trade revenue from neighboring countries separately from other oil trade outside the Oil for Food program. Like GAO, the committee calculated the volume of oil sold on the basis of Iraq's production, internal consumption, and foreign trade. However, it used SOMO data for these calculations and did not apply a discount rate.

Other Estimates of Illicit Revenue

In addition to smuggling and contract surcharges and kickbacks, the Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, included other categories in its estimate of Iraq's illicit revenues. For example, the Subcommittee estimated that Iraq gained $2.1 billion in illicit revenue from substandard goods. This scheme involved contracting first-quality goods, although the actual goods delivered were of lesser quality. The supplier received a small percentage of the difference and the Iraqi government kept the rest. The estimate was based on anecdotal information provided by officials of the former Iraqi regime, the UN, and the U.S. government. The estimate assumed that, from 1997 through 2003, on average, about 5 percent of all goods delivered under the Oil for Food program were substandard.

Appendix IV: UNCC Organization and Its Claims Categories and Amounts

This appendix provides more detailed information on the organization of UNCC and how claims were decided based on the different categories of claims.

UNCC Formation and Organization

The UN Security Council established UNCC in 1991 to process claims and pay compensation for damages and losses resulting from Iraq's invasion and subsequent occupation of Kuwait. Security Council resolution 687 of April 3, 1991 established Iraq responsibility for such losses stating that "Iraq...is liable under international law for any direct loss, damage, including environmental damage and the depletion of natural resources, or injury to foreign Governments, nationals and corporations, as a result of Iraq's unlawful invasion and occupation of Kuwait." On May 20, 1991, the Security Council adopted resolution 692, which established UNCC and the UN Compensation Fund. With the adoption of Security Council Resolution 986, UNCC, along with UN-sponsored humanitarian programs in Iraq, received funding from the profits from Iraqi oil sales.

UNCC is a subsidiary organ of the UN Security Council and is comprised of three entities—the Governing Council, the panels of Commissioners, and the UNCC Secretariat. The Governing Council, whose membership is the same as that of the Security Council, is the principal policymaking organization within UNCC. The Governing Council approves the award decisions recommended by the panels of Commissioners. The three-member panels were responsible for reviewing the claims and making recommendations on whether to award claimants and the amounts to be awarded. Commissioner panels included experts in the fields of law, accounting, insurance, and environmental damage assessment. Commissioners were nominated by the UN Secretary General and appointed by the UNCC Governing Council on the basis of professional qualifications, experience, and geographic representation. The UNCC Secretariat organized the claims and provided support to both the Governing Council and the Commissioners panels.

UNCC's Claims Categories and Amounts

UNCC divided claims into six classes (A through F). Individuals and their families filed A, B, and C claims—known collectively as the small claims categories—for damages and losses up to $100,000. The large claims categories—D, E, and F—were filed by individuals petitioning for $100,000 or more in damages and losses, and from corporations, international organizations, and governments. Although the number of small claims was much higher, larger claims accounted for about 95 percent of the compensation sought. Claimants in the D, E, and F categories petitioned

for millions—and in some instances billions—of U.S. dollars. Table 3 summarizes the claims categories and the types of losses and damage UNCC compensated.

Table 3: UNCC Claims Categories

Claim category	Claim description
Small claims categories	
A claims	Submitted by individuals forced to leave Iraq or Kuwait because of the Iraqi invasion of Kuwait. Individuals and families who intended to file claims in other categories were awarded $2,500 and $5,000, respectively. Individuals and families that agreed not to file other claims were entitled to receive $4,000 and $8,000, respectively.
B claims	Submitted by individuals who suffered serious personal injury by the Iraqi invading force or whose spouse, child, or parent died as a result of the invasion and occupation of Kuwait; individuals were awarded $2,500, and families were awarded up to $10,000.
C claims	Submitted by individuals for damages up to $100,000 for 21 different types of losses, including those relating to departure from Kuwait or Iraq; personal injury; mental pain and anguish; loss of personal property; loss of bank accounts, stocks, and other securities; loss of income; loss of real property; and individual business losses.
Large claims categories	
D claims	Submitted by individuals for damages over $100,000 for 21 different types of losses, including those relating to departure from Kuwait or Iraq; personal injury; mental pain and anguish; loss of personal property; loss of bank accounts, stocks, and other securities; loss of income; loss of real property; and individual business losses.
E claims	Submitted by corporations, other private legal entities, and public sector enterprises for construction or other contract losses; losses from the nonpayment for goods or services; losses relating to the destruction or seizure of business assets; loss of profits; and oil sector losses.
F claims	Submitted by governments and international organizations for losses incurred in evacuating citizens; providing relief to citizens; damage to diplomatic premises; loss and damage to other government property; and damage to the environment.

Source: GAO analysis based on UNCC data.

Claimants for the small categories were awarded $8.43 billion—a little more than half of the $15 billion in compensation they requested, while large category claimants were awarded about $44 billion, or about 13 percent of the $338 billion they requested. UNCC set the amount of compensation that could be requested and awarded for A and B category claimants.[1] (See fig. 4).

[1]At its first meeting, the Governing Council classified A, B, and C claims as "urgent claims" and required that their review be expedited. In general, expedited procedures meant that the panels spent less time reviewing individual claims and depended on methods to effectively process claims en masse.

Figure 4: Claims Received and Awarded by Category

Claim category	Number of claims received	Compensation sought (Dollars in billions)	Number of claims awarded	Compensation awarded (Dollars in billions)
A claims	923,158	$ 3.46	859,176	$ 3.21
B claims	5,734	.02	3,941	.01
C claims	1,736,265	11.50	672,829	5.21
D claims	13,863	16.54	10,348	3.35
E claims[1]	6,694	84.88	4,105	26.61
F claims	393	236.13	285	14.08
Total	**2,686,107**	**352.52**	**1,550,684**	**52.47**

Source: GAO based on UNCC data.

[a]Claims in the E category include totals for export guarantee and insurance claims submitted to UNCC, which were designated as an E/F subcategory. There were 123 E/F claims, seeking $6.1 billion in compensation, of which 57 were award $311 million in compensation.

By late January 2006, the UNCC had paid about $20.3 billion in compensation, mostly to individuals and families, leaving about $32.2 billion in outstanding unpaid awards. Almost all of the amount yet to be paid is for claims in the E and F categories; i.e., claims submitted by corporations and governments. UNCC officials noted that the small outstanding amounts currently in the A and C categories are for individuals who have not been located and therefore were unable to receive awards. Category B claims have been paid entirely.

Appendix V: Comments from the Department of State

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of State

Assistant Secretary and Chief Financial Officer

Washington, D.C. 20520

MAR 16 2006

Ms. Jacquelyn Williams-Bridgers
Managing Director
International Affairs and Trade
Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548-0001

Dear Ms. Williams-Bridgers:

We appreciate the opportunity to review your draft report, "UNITED NATIONS: Lessons Learned from Oil for Food Program Indicate the Need to Strengthen UN Internal Controls and Oversight," GAO Job Code 320320.

The enclosed Department of State comments are provided for incorporation with this letter as an appendix to the final report.

If you have any questions concerning this response, please contact Betsy Fitzgerald, Foreign Affairs Officer, Bureau of International Organization Affairs, at (202) 736-7740.

Sincerely,

Bradford R. Higgins

cc: GAO – Audrey Solis
IO – Kristen Silverberg
State/OIG – Mark Duda

Department of State Comments on GAO Draft Report

UNITED NATIONS: Lessons Learned from Oil for Food Program Indicate the Need to Strengthen Internal Controls and Oversight (GAO-06-330, GAO Code 320320)

We appreciate the opportunity to comment on your draft report, "United Nations: Lessons Learned from Oil for Food Program Indicate the Need to Strengthen Internal Controls and Oversight."

With regard to the recommendation:

"We recommend that the Secretary of State and the Permanent Representative of the United States to the UN work with other member states to encourage the Secretary General to (1) ensure that future sanctions programs establish, apply and enforce the principles of internationally accepted internal control standards, with particular attention to comprehensive and timely risk assessments; and (2) strengthen internal controls throughout the UN system based in part on the lessons learned from the Oil for Food program."

The U.S. Mission to the United Nations is working diligently on a number of UN reform issues, including strengthened internal controls. However, recommendation (1) would not apply to all sanctions regimes, only to regimes such as OFF where comprehensive sanctions have been placed on a government and the UN is managing considerable financial flows and a large humanitarian program. No such sanctions regime is in place at present. If such a regime were to be put in place some time in the future, this recommendation for tightened internal controls would be appropriate.

With regard to the report itself:

The report correctly credits the OFF Program with having helped to avert a humanitarian crisis in Iraq, one of its primary objectives, and in limiting Iraq's ability to purchase military-related and WMD items. The report does appropriately commend efforts through retroactive oil pricing to limit oil surcharges.

See comment 1.

The report criticizes the UN for having failed to put in place internal controls to prevent Iraq and others from manipulating the program and circumventing

sanctions, an outcome the report notes was the direct result of the "UN's" decision to allow Saddam to sell oil to whom he chose and to purchase goods from the dealers he selected. The "UN's" decision in this regard, however, was one taken by Security Council Member States, not Secretariat officials. There is a fundamental distinction between actions for which the Secretary General and his officials must take responsibility and actions in the Security Council for which Member States (serving on the Council) must take responsibility - a distinction that may not be consistently clear in the GAO report.

The report does acknowledge that concessions to the Government of Iraq regarding oil sales and goods purchases were made "against a backdrop of pressure to maintain sanctions while addressing emergency humanitarian needs."

See comment 2.

The report does not highlight the Council's inaction in the face of awareness of non-compliance and corruption in the sanctions regime. While tolerance of certain non-compliance, for example in regard to smuggling to Jordan and Turkey, was conscious and understandable, it is harder to understand the tolerance by some on the Security Council of other, broader areas of non compliance.

See comment 3.

On accountability, the repeated assertions that the diffusion of responsibility among numerous entities meant that no single entity was in charge and accountable for the program in its entirety seems overstated. While diffusion certainly existed and no doubt contributed to the problem, the Secretary General and his Deputy were ultimately responsible for the administration of the huge and important OFF Program. They should have reported fully and accurately any problems that may have arisen, including as a result of the decisions of the Security Council or any diffusion of responsibility.

See comment 4.

A central theme is that the OFF Program was manipulated, and the sanctions circumvented, because there were insufficient internal program controls. There is little discussion in the report of the political dynamics, both globally and in the Council, that governed international efforts to contain Saddam Hussein's regime. Simply imposing more oversight and program controls without collective political will to take action to address sanctions non-compliance would not have corrected the problems.

See comment 5.

See comment 6.

In addressing the UNCC, the report merely restates OIOS findings, without making it clear that they are OIOS findings and not GAO findings. The report does not address the fact that the OIOS findings are in dispute. Furthermore, the Department of State does not agree with many of OIOS's characterizations, especially on the exchange rate issue and on OIOS's review of decisions made by the Panels of Commissioners, which is outside the scope of OIOS's auditing authority.

See comment 7.

We would like to highlight the exchange rate issue with regard to the UNCC. OIOS has not accepted the expert opinion of Professor Crawford, released in August 2005, on the issue of currency exchange rates. Crawford's opinion explains that according to international legal standards and common practices used by other compensation commissions and tribunals, the appropriate date for use of the exchange rate converting UNCC award payments into local currency is the date of loss. OIOS asserts that the date of payment is the appropriate date because that is the date used in accordance with the UN Financial Regulations and Rules for UN commercial transactions. Because the payments of awards under the UNCC is that of a compensation commission not a commercial transaction, the appropriate exchange rate practice should follow international legal standards, not UN financial regulations. Therefore, OIOS's finding that the UNCC has made $500 million in overpayments is a gross mischaracterization. The UN Board of Auditors did not support OIOS's position on this and its September 2005 management letter recommended that the UN Secretariat review this matter with OIOS and UNCC. If the GAO is not prepared to reject the clearly erroneous OIOS findings, it is vital that the report at least clearly reflect both sides of this dispute.

See comment 8.

On the matter of OIOS's proper scope of auditing authority, OIOS has reviewed decisions made by the Panels of Commissioners, which are legal decisions that auditors are not qualified or authorized to review. The UNCC sought legal advice from the UN Office of the Legal Counsel on whether OIOS's review activities in this regard were appropriate. The UN Legal Counsel determined that OIOS review of the Panel's decisions was not within its scope of auditing authority and the UNCC considers OIOS to be bound by this decision whereas OIOS does not. Again, your report needs to fully address both sides of this issue.

See comment 9.

With regard to overpayments, the GAO report states that as of May 2005 governments and international organizations owed UNCC $38.8 million in

claims they were unable to pay due to unlocated claimants. This amount represents governments/organizations that have not reported to the UNCC on whether amounts received have been paid out or not and hence changes on a daily basis as reports come in. For example, as of March 2006, this amount had changed to $11.7 million. The report mischaracterizes this number and should reflect that the majority of the $38.8 million represents amounts governments have not reported on with only a few million dollars of that amount representing funds that were delinquently held by governments.

The following are GAO's comments on the Department of State's letter dated March 16, 2006.

GAO Comments

1. We disagree with State's assertion that the report does not clearly distinguish between the responsibilities and actions of the Secretary General and the Security Council. For actions attributed to both the Security Council and the Secretariat, our report collectively refers to the UN. For actions taken by one or the other entity, we clearly denote whether it is the Security Council or the Secretariat. State commented that the member states of the Security Council were responsible for the decisions that allowed Iraq to manipulate the program and circumvent sanctions, not the Secretariat or the "UN." Although the Security Council was responsible for approving the agreement with Iraq, we disagree with State's assertion that the Secretariat did not play a part in the agreement. We note that the Secretariat negotiated and the Secretary General signed the May 1996 memorandum of understanding between the UN and Iraq, and the Security Council approved it. This agreement allowed Iraq to choose its oil buyers and commodity suppliers and directly negotiate contract terms. Therefore, the UN was collectively responsible for allowing a control environment that enabled Iraq to obtain illicit revenues through surcharges and kickbacks.

2. We disagree with State's comment that the report does not highlight the Security Council's inaction in the face of and corruption in the sanctions regime. We provide a clear discussion on how the Security Council's lack of action failed to prevent smuggling to neighboring states. Our report further notes that successive U.S. administrations issued annual waivers to Congress exempting Turkey and Jordan from unilateral U.S. sanctions for violating UN sanctions against Iraq. State commented that "smuggling to Jordan and Turkey was conscious and understandable," but noted that other, unspecified tolerance by other Security Council members was harder to understand. We do not distinguish between "conscious and understandable" smuggling and other types—all smuggling violated UN sanctions and allowed a corrupt regime to obtain illicit revenues outside the Oil for Food program.

3. We disagree with State's comment that the report overstates the diffusion and lack of clarity regarding the program's management

and oversight. While we agree that the Secretariat, through the Office of the Iraq Program, was responsible for the day-to-day management of the Oil for Food program, the Security Council's Iraq sanctions committee was responsible for key oversight functions, including contract and oil pricing reviews and sanctions enforcement. As State points out in an earlier comment, the Security Council was also responsible for policy decisions that affected Iraq's ability to manipulate the sanctions and Oil for Food program to its benefit. Moreover, as figure 3 in our report demonstrates, numerous other entities were responsible for various management and oversight aspects of the Oil for Food program and sanctions enforcement, including border inspectors, oil overseers, an interception force, nine UN agencies, and several audit offices. The Oil for Food program was large and complex and required management and oversight by multiple entities. However, the absence of clear leadership and lines of authority were significant structural weaknesses in the program.

4. We reported in our section on information and communication that OIP failed to fully report to the Security Council's sanction committee information on contract surcharges, kickbacks, and smuggling and that such disclosure may have mitigated some of Iraq's manipulation of the program. State correctly observes that the Secretariat should have reported ongoing problems to the Security Council. This observation further supports our finding that the Secretariat was not the only entity responsible for the Oil for Food program and that leadership and accountability were diffused.

5. State emphasized the role of political will in addressing noncompliance with sanctions, stating that stronger internal controls without political will might not have corrected the Oil for Food Programs problems. State further commented that the report has little discussion about the global and political dynamics that governed international efforts to contain Saddam Hussein. State undervalues the importance of an internal control framework. Among other elements, internationally accepted principles of internal control require that responsible entities (1) provide an overall structure of accountability including clear lines of authority and responsibility; (2) conduct a comprehensive risk assessment, including the external context affecting the program; and (3) ensure that timely information be provided to decision makers. Although these controls might not have identified the oil

smuggling, they would have identified and made transparent specific program vulnerabilities and established clear accountability. This would have helped mitigate the kickbacks on commodity contracts by establishing accountability for contract pricing. However, we have added additional information to the report about the political context of the program.

6. We disagree with State comments that our report merely restates OIOS findings about UNCC without making it clear that they are OIOS findings. Our report makes clear that the findings about UNCC are OIOS and not GAO findings. In response to State's comment that we do not present both OIOS and UNCC sides, we have clarified the report to note that UNCC has disputed OIOS findings (see comment 7).

7. State commented that we do not present the views of both OIOS and UNCC in the discussion of potential overcompensation due to the improper use of the exchange rate date. Our report does not discuss or refer to the exchange rate issue. We cite more than $500 million that OIOS refers to as potential overcompensation due to calculation errors, insufficient evidence to support losses, and duplicate claims.

8. In response to State's comment that we do not sufficiently discuss the issue of OIOS's proper scope of audit authority, we have added additional information to the report about the legal challenge to OIOS's audit authority and the UN Office of Legal Affair's opinion.

9. We have clarified and updated information on the amount of the UNCC awards that governments and international organizations have either not reported or not paid out.

Appendix VI: Comments from the UN Compensation Commission

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

UNITED NATIONS

SECURITY COUNCIL

UNITED NATIONS COMPENSATION COMMISSION

NATIONS UNIES

CONSEIL DE SÉCURITÉ

COMMISSION D'INDEMNISATION DES NATIONS UNIES

COMMENTS OF THE UNITED NATIONS COMPENSATION COMMISSION ON THE DRAFT REPORT OF THE GENERAL ACCOUNTABILITY OFFICE DATED 17 MARCH 2006

See comment 1.

1. At the outset, the UNCC secretariat questions the rationale for the inclusion of the UNCC in a report, the topic of which is lessons learned from the oil-for-food programme. Similar to the oil-for-food programme (as well as UNMOVIC and its predecessor UNSCOM), the UNCC is financed from the proceeds of Iraqi oil exports. But the UNCC has never been part of the oil-for-food programme, as is evident from the fact that the UNCC was established in 1991, nearly six years before the creation of the oil-for-food programme. It is also clear from the opening paragraph of the draft GAO report, wherein the nature and intent of the oil-for-food programme and its key entities are described, which have nothing to do with the UNCC. There was never any administrative connection or reporting system between the two entities. Unfortunately, the inclusion of the UNCC in the draft report cannot but suggest that it was or is part of the oil-for-food programme. The report is therefore misleading, and inevitably taints the UNCC with the problems that plagued the oil-for-food programme. To the best of the secretariat's understanding, the only reason that the UNCC has been linked to the oil-for-food programme is because OIOS, for reasons unknown and incomprehensible to the UNCC, apparently forwarded to the Independent Inquiry Committee ("IIC") copies of reports on its audits of the UNCC at the same time that it forwarded copies of reports on its audits of the oil-for-food programme, the latter having been requested by the IIC. While the secretariat has no difficulty with the GAO reviewing the UNCC, it would be appropriate to do so by way of a separate report, in order to reflect the distinct status and nature of the UNCC.

See comment 1.

2. If the GAO is not in a position to issue a separate report, the secretariat would like to request that the UNCC be dealt with in a separate chapter of the report and that the delineation between the UNCC and the oil-for-food programme be made clear. At present, references to the UNCC are spread out over pages 1, 2, 5-7, 20, 30, 31, 32-37, 43-44 and Appendices I and IV of the draft report. Moreover, the juxtaposition of references to the oil-for-food programme and the UNCC in the draft GAO report (in particular, at page 1 under the headings "Lessons Learned from Oil for Food Program Indicate the Need to Strengthen UN Internal Controls and Oversight" and "Why GAO Did This Study", at pages 2 and 5-7 and at page 20) give the inaccurate and unfortunate impression that the UNCC was part of the oil-for-food programme.

See comment 2.

3. A separate chapter on the UNCC would also facilitate a more expansive description of the organization, including the Security Council resolutions under which it was established, its status as a subsidiary organ to the Security Council, its mandate to

2

process claims and pay compensation for direct loss, damage or injury resulting from Iraq's invasion and occupation of Kuwait, its three principal components (the Governing Council, Panels of Commissioners and secretariat) and the work that it has performed. It is important, for example, for readers of the GAO report to appreciate that the Governing Council is the principal policy-making organ of the UNCC, has the same composition as the United Nations Security Council, approved recommendations for awards of compensation made by Panels of Commissioners in their reports on instalments of claims, and to date has taken all of its decisions by consensus. It is also important for readers to understand that, under the UNCC's Provisional Rules for Claims Procedure, the three-member Panels of Commissioners were entrusted with reviewing the claims and making recommendations for awards of compensation and, in doing so, to determine the applicable law and assess the relevance of and weight to be given to the evidence. Further, it is important for readers to appreciate that, in accordance with the report of the Secretary-General to the Security Council dated 2 May 1991, adopted by the Security Council in Resolution 692, the Commissioners were experts in such fields as law, finance, accountancy, insurance and environmental damage assessment. Commissioners acted in their personal capacity and were nominated by the Secretary-General and appointed by the Governing Council on the basis of their professional qualifications, experience and integrity, as well as the need for geographical representation. It would also be helpful for readers to know that the secretariat provided support and services to both the Governing Council and Panels of Commissioners.

See comment 3.

4. The secretariat is concerned that the draft report does not refer to the fact that all of OIOS' audit reports were the subject of comprehensive and detailed responses by the UNCC. Those responses document the UNCC's disagreement with many of OIOS' audit observations, findings and recommendations and the reasons therefore, and show that in many instances the OIOS field auditors did not understand the claims review procedures developed by Panels of Commissioners and applied to the verification and valuation of claims. In other instances, the UNCC objected to OIOS attempting to act as an appellate body and substitute its judgment for that of the Panels of Commissioners on the applicable law and the evaluation of evidence. Indeed, it was the attempts of OIOS field auditors with no legal training to insist that their views on questions of law and evidence be substituted for the judgment of the Panels of Commissioners that led the secretariat to propose to OIOS (which did not object) that an opinion be sought from the UN Office of Legal Affairs ("OLA") as to the proper scope of audit of claims processing.

See comment 4.

5. Brief mention is made at pages 30 and 36-37 of the draft GAO report to "challenges" to OIOS' authority from the UNCC and OLA and at pages 35 and 36-37 to a UN legal opinion, however, insufficient explanation is given and no context is provided. In November 2002 the secretariat asked OLA to opine on whether OIOS might properly review the following three aspects of the work of Panels of Commissioners:

(a) their identification of the applicable law and their application of that law to claims pursuant to the UNCC's Provisional Rules for Claims Procedure;

(b) the manner in which they organized their work pursuant to those Rules; and

(c) their determinations regarding the sufficiency of evidence, including their determinations relating to the relevance, materiality and weight of evidence pursuant to the Rules.

6. In his opinion dated 27 November 2002, The Legal Counsel stated that these three aspects of the work of Panels of Commissioners constituted elements of a legal process and that OIOS' functions did not extend to the examination, review and appraisal of decisions that were the results of a legal process. Likewise, they did not include the examination, review and appraisal of decision-making that took place in the course, and as an integral part, of such a process. While the Memorandum of Understanding entered into by the UNCC and OIOS in June 2003 provided that OIOS was to take the OLA legal opinion into consideration in its audit of claims processing, OIOS has essentially failed to do so. It is interesting that the GAO characterizes such refusal as OIOS taking "an aggressive stance"; others might consider the refusal as wilful disregard of the legal opinion of the UN's Legal Counsel. In any event, it is important for readers to understand that the UNCC considers itself bound by the OLA opinion. The secretariat emphasizes that the OLA legal opinion relates only to the three enumerated aspects of the work of Panels of Commissioners, which are essentially quasi-judicial in nature. It does not purport to exclude OIOS audit of other aspects of the UNCC's operations, including financial aspects such as the payment of awards of compensation and expenditure under the budget or the identification of waste or fraud.

See comment 4.

7. The secretariat's concerns are illustrated by the reference at page 6 (and again at pages 35 and 37) of the draft report to OIOS having reported that more than $500 million in awards may have been too high due to duplicate payments, calculation errors, insufficient evidence and inconsistent methodologies and to the UNCC having agreed to reduce overpayments by $3.3 million. The secretariat believes this to be a reference to OIOS' audit of claims in part two of the third instalment of category "F3" claims (claims filed by the State of Kuwait, apart from environmental claims), as a result of which OIOS asserted that the claimants had been overcompensated by approximately $419 million. Unfortunately, no reference is made in the draft GAO report to the UNCC's extensive responses to OIOS wherein the secretariat explained, *inter alia*, why OIOS was mistaken in its view that the claimants filed duplicate claims for the same losses (duplication checks had been carried out as part of the review of the claims), the reasoning behind and application of the evidentiary standards matrix developed by the Panel to assess evidence and how OIOS had misunderstood the claims review procedures and adjustments used by the Panel to verify and value the claims. The UNCC agreed with the two calculation errors helpfully spotted by OIOS and also identified a third such error in the course of responding to the OIOS audit reports. The three calculation errors, which gave rise to a total "over award" of some $2.5 million, were corrected under the UNCC's Rules. Since the full amount of the award had not been paid out, no actual overpayment occurred.

See comment 5.

8. OIOS also asserted in the aforesaid audit and in its audits of other instalments of claims that overpayments arose as a result of the currency exchange rate applied by the Panels of Commissioners to convert claims denominated in currencies other than United States dollars for the purpose of recommending awards of compensation. Indeed, the secretariat understands that this issue accounts for the vast majority of the overpayments alleged by OIOS. The Panels of Commissioners, independently but unanimously, and following a well-established line of legal authority, determined that the appropriate date to use for the currency conversion was the date of loss. The OIOS field auditor was of the view that the appropriate date was the date of payment. In its communication to the GAO dated 30 December 2005, the secretariat referred to the expert opinion obtained on the issue by the IIC (which provided a copy to OIOS) from Professor James Crawford of

See comment 6.

Cambridge University and noted that Professor Crawford had opined that the Panels of Commissioners had acted in accordance with normal international claims practice in using the date of loss. The UNCC does not understand why OIOS apparently refuses to accept this expert opinion.

See comment 7.

9. Reference is also made at page 6, and again at pages 33, 34 and 36 of the draft GAO report, to some $38.8 million in unclaimed payments that Governments and other submitting entities had not returned to the UNCC. The figure used is misleading and requires explanation. Under Governing Council decisions 18 and 48, Governments and other submitting entities are responsible for the distribution of compensation awards to successful claimants and for providing reports to the UNCC with respect thereto. In those cases where claimants cannot be located within a specified period of time, the amount that would have otherwise been paid to them is to be returned to the UNCC. At the same time, the UNCC received regular requests from Governments and other submitting entities for the repayment of these amounts as claimants are located. In the result, the amount of "unclaimed payments" fluctuates almost daily. The total reported by the secretariat to the Governing Council at its most recent session in March 2006 was $11.7 million.

See comment 8.

10. The suggestion that this is due to inadequate oversight by the UNCC secretariat is unfounded. The secretariat sends reminders to submitting entities of the due dates for reports and follows up regularly when reports are late. Contrary to OIOS' assertions set out at pages 34 and 36 of the draft GAO report, the secretariat reviews every single report on the distribution of payments and refunds for unlocated claimants and enters the individual claim details in the UNCC database. Where details are not provided, the secretariat requests them. In short, there are no claims for which the secretariat does not have the requisite details. Further, since December 2005, the secretariat has requested that submitting entities provide specific address and personal details for all newly located claimants in their requests for repayment. The secretariat also notes that the UN Board of Auditors, in its report on the UNCC's financial statements for the 2002-2003 biennium, specifically commended the UNCC for its close monitoring of reports on the distribution of payments.

See comment 9.

11. At page 36 of the draft GAO report reference is made to the provision of audit certificates. Again, OIOS' figures are misleading. It is important for readers to understand that the Governing Council decided to require audit certificates at its September 2003 session, for payments starting in October 2003. At present, only $1.5 million of payments have not been supported by audit certificates (0.8 per cent of the $197.2 million in payments for which audit certificates were due). The secretariat follows up in each case where an audit certificate has not been provided.

See comment 10.

12. Reference is made at pages 32 and 34 to the phasing out of the UNCC. The secretariat notes that the GAO's information is somewhat outdated and is pleased to provide the following update. Processing of the approximately 2.6 million claims filed with the UNCC was completed in mid-2005. The secretariat expects that by mid-2007 the payment of all individual awards and certain residual activities will be completed. Thereafter the Compensation Fund will be maintained under the continuing oversight of the Governing Council, supported by a residual secretariat in Geneva, as an interim arrangement while the Governing Council keeps open for consideration at a future date the option of transferring responsibility for continuing payments to the Government of Iraq under the supervision of the Security Council.

See comment 11.

13. The secretariat has also noted that in Table 3 in Appendix IV the award amounts indicated for category "A" claims are for individuals and families that intended to file claims in other categories. Individuals and families that agreed not to file other claims were entitled to receive $4000 and $8000 respectively. With respect to category "B" claims, the words "up to" should be added before the figure $10,000.

14. The secretariat is grateful for the opportunity to provide its comments on the draft GAO report and hopes that these comments will be taken into consideration in the finalization of the report.

Rolf G. Knutsson
Executive Secretary

10 April 2006
Geneva

The following are GAO's comments on the UN Compensation Commission's letter dated April 10, 2006.

GAO Comments

1. In response to the UNCC's concern that we are including UNCC in a report on Oil for Food, we have further clarified the report to note that UNCC is a separate entity. Our draft report made a clear delineation of UNCC and Oil for Food in the structure of the report. We included UNCC in the report because, under the terms of UN resolution 986, Iraq's oil revenues funded both the humanitarian program and the reparations. Because the reparations amounted to 25 to 30 percent of Iraq's oil revenues and about $20 billion, we could not responsibly omit this important element of the sanctions in reporting to Congress.

2. In comments on our report, UNCC noted that a separate chapter on its activities would facilitate a more expansive description of its organization and the claims process. We have added information about the organization of UNCC in the body of the report and in appendix IV.

3. UNCC noted that our draft did not include adequate information about its detailed responses to the OIOS audit reports and findings and that UNCC disagreed with most OIOS findings. We have added information to the body of the report that describes the UNCC responses to OIOS audit reports. We note that our report does not analyze either OIOS findings or the UNCC responses.

4. UNCC commented that brief mention is made of UNCC's challenges to OIOS's audit authority as well as the UNCC position on this matter. Furthermore, UNCC stated that the view of the UN Office of Legal Affairs was not sufficiently presented. We have provided additional explanation and context on the UNCC-OIOS legal relationship and have expanded on the UN Office of Legal Affairs opinion.

5. With regard to our description of the OIOS report identifying $419 million in potential overcompensation, UNCC noted that we did not describe its detailed response to the OIOS report, which disputed the findings. We have added information to the report on the UNCC response to the OIOS report.

6. UNCC commented that a large majority of the claimed overpayments are based on the date of the currency exchange rate and that the correct date should be the date of the loss, consistent with international norms. We did not and do not report or comment on this issue in our report.

7. We have updated our report to reflect the current amount of unclaimed payments.

8. UNCC commented that it disputed the OIOS assertions that its oversight of governments' unpaid claims was inadequate and that it provided oversight of all reports on the distribution of payments and refunds. We have added more information from the UNCC June 16, 2005, response to the OIOS audit dated May 27, 2005.

9. We have updated our report to reflect the current amount of payments not supported by audit certificates.

10. We have updated the information provided by the Department of State about the phasing out of UNCC, according to documentation UNCC provided to us in April 2006.

11. We have revised the table, inserting the additional award information for category "A" and inserting the words "up to" before $10,000 in category "B."

Appendix VII: GAO Contacts and Staff Acknowledgments

GAO Contact

Joseph A. Christoff, Director (202) 512-8979

Staff Acknowledgments

In addition to the individual named above, Mona Nichols Blake, Jeanette Espinola, Tetsuo Miyabara, and Audrey Solis made key contributions to this report. Richard Boudreau, Lynn Cothern, Bonnie Derby, Hynek Kalkus, Bruce Kutnick, Don Morrison, Valérie Nowak, George Taylor, Ann Ulrich, and Judith Williams provided technical assistance; Etana Finkler provided graphics assistance; and Mary Moutsos provided legal assistance.

Related GAO Products

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