

# UN-HABITAT

## PRESS RELEASE



UNHSP/2/05

### **Clarification of UN-HABITAT's Audit Reports under OFFP in Iraq**

**Nairobi, 12 January 2005:** Mr. Paul Volcker and the Independent Inquiry Committee (IIC) released on 9 January 2005, on their website, 58 internal audit reports on the Oil-for-Food Programme (OFFP) and the UN Compensation Commission. In addition, they put out a briefing paper on the audit reports. Five of the 58 audit reports published are on UN-HABITAT operations.

UN-HABITAT welcomes the progress made so far by the Volcker Committee and eagerly awaits its interim and final reports as requested by the Secretary-General.

As observed by Mr. Volcker, UN-HABITAT is indeed the only one out of the nine implementing agencies that performed duties relating to the OFFP under the purview of the OIOS and is audited by its Internal Audit Division (IAD). UN-HABITAT's internal audits have therefore been published along with others from OIOS-audited departments. Other agencies have their own in-house oversight functions.

UN-HABITAT welcomes this development, bound to increase transparency and accountability to UN Member States and the general public. In order to provide the full context of the audits in question, UN-HABITAT wishes to point out that 4 of the 5 OIOS audits were conducted at the request of the Executive Director (appointed in September 2000). Upon her arrival at UN-HABITAT, the Executive Director, Mrs. Anna Tibajuka, in pursuit of transparency, accountability and efficiency, adopted a policy of using audit as a management tool to guide large construction programmes being implemented by the agency in post-conflict environments as in Iraq. Such oversight is necessary in post-conflict reconstruction situations where management structures have to evolve rapidly overtime. The Executive Director requested the OIOS to be constructive and critical since the objective was to use the internal audits to improve management and efficiency of operations in difficult environments. UN-HABITAT feels that this needs to be taken into account in interpreting some of the findings of the OIOS audits now that they are in the public domain.

UN-HABITAT wishes to acknowledge and thank the management and staff of OIOS for the assistance in the implementation of its activities in Iraq and is pleased to attach a brief summary on the achievements of its programme and further clarification on the audit recommendations.

### **Settlements Rehabilitation Programme in northern Iraq**

The Settlements Rehabilitation Programme (SRP) carried out in the northern Iraqi Governorates of Arbil, Dahuk and Sulaimaniyah from 1997 – 2003 benefited 1,349,200 persons directly, that is one third of the region's population. The SRP completed 21,268 houses for Internally Displaced Persons (IDPs) and other vulnerable groups, 765 primary and secondary schools, 134 health centres, 905 km of water and sanitation systems, 2,940 km of roads, 34 bridges, and 225 agricultural and community facilities. These indisputable achievements were delivered in a very difficult humanitarian environment, compounded by the hostility of the Saddam Hussein regime to the Kurdish region which was outside its effective control and managed by its political opponents and local authorities.

## **The Auditing Context**

Over the course of the SRP, UN-HABITAT received a total allocation of US\$ 520 million. During that period, the Agency awarded 1,372 contracts to local contractors for a total of US\$ 461 million. By November 2003, when the SRP was handed over to the Coalition Provisional Authority (CPA) in Iraq, total disbursements amounted to US\$ 353 million.

Capital investment in housing represented the largest sector allocation (35%), followed by education (25%), transportation (17%), water and sanitation (14%), health (5%), and finally community facilities and agricultural support infrastructure (4%). In housing, the average cost was US\$ 4,547 per house or US\$ 57 per square metre. Clearly this standard in construction efficiency would be hard to beat given prevailing conditions in Northern Iraq. UN-HABITAT managed to achieve this by using local contractors and building their capacities over time. As a result a large number of low-cost houses were built and benefited IDPs and vulnerable families who in their total formed about two-thirds of the population of northern Iraq.

Given the scale of the SRP and large sums of money involved, as pointed out at the outset, UN-HABITAT recognised the need to rely on regular internal audits to encourage transparency and accountability and progressively strengthen its project management practices and efficiency. UN-HABITAT believes that this strategy worked quite well as OIOS audits did not expose any malpractice by any staff member both in the field and at headquarters, and so naturally their findings and recommendations focused on strengthening management and efficiency. UN-HABITAT welcomed and considered the advice and took steps, where necessary, to implement the actions recommended by OIOS.

The cumulative total of recommendations from the 5 Audits is 130, as illustrated by the attached Table 1 showing the status of OIOS recommendations. OIOS can confirm that only two contentious issues related to delays in the implementation of the currency fluctuation clause, and to payments to local authority officials overseeing the SRP, remained on its books as outstanding. The appropriate action taken on these two issues has since been brought to the attention of the Under-Secretary-General for the OIOS by UN-HABITAT's Executive Director for the final formal closing of the recommendations.

One of the points raised by OIOS was the legal and political ramification of payments to local authority inspectors. In any country, the inspection function belongs to the relevant government institutions. Though local authorities were not recognized, they were the de facto governing bodies in northern Iraq, and had no funds to dispatch their inspectors to the field. In line with the common practice of the UN Office of the Humanitarian Coordinator in Iraq (UNOHCI) and UN agencies in northern Iraq, UN-HABITAT paid to inspectors participating in joint inspection teams to the more than 2000 project sites, local per diems based on actual field visits. This resulted in the payment of \$625,000 cited by OIOS.

A major problem encountered by all UN activities in northern Iraq at the time, was the erratic fluctuation of the unofficial currency, the Old Iraqi Dinar, exacerbated by the total absence of a banking system. The Office of the UN Treasurer recommended in 1998 that UN Agencies in northern Iraq adopt a currency fluctuation clause. UN-HABITAT complied with this recommendation and the clause was introduced under guidance of the United Nations Office at Nairobi (UNON) and UNOHCI as a measure to protect small local contractors in northern Iraq against losses. Under the clause, contractors had to absorb up to 10% of fluctuations, while UN-HABITAT met fluctuations over 10% but limited to a maximum of 30%.

The clause worked both ways. UN-HABITAT benefited when the Old Iraqi Dinar was weak making construction costs to remain low over an extended period of time. However, when the Dinar strengthened and appreciated against the dollar, the situation turned in favor of contractors. It was at this stage that the OIOS recommended abolishing the clause. In accepting this recommendation, UN-HABITAT pointed out to OIOS that contractors were likely to resist the sudden abolition of what had become a standard contractual condition. Implementing the recommendation involved protracted negotiations with contractors and local

authorities during which the clause remained in force, resulting in payments to 145 contractors which were “nearly \$ 1.7 million” higher than what they would have been if the clause had been removed instantly.

UN-HABITAT does not consider this “a loss” since the opportunity cost of failure to institute a dialogue with contractors in pursuit of an orderly and smooth implementation of the OIOS recommendation would have been much higher in terms of suspension of activities by contractors in an environment without performance bonds due to lack of banking facilities. In spite of these remedial measures, there were still a number of strikes by contractors as they felt their financial risks were too high. It can be verified that following the implementation of this recommendation tender prices increased by up to 40% wiping out any gains that might have been initially made after removal of the clause and noted in the OIOS audit as \$479,951 in October 2002 (para 29 of the 3<sup>rd</sup> Audit). Moreover, the cost increase of US\$ 1.7 million is also a very limited amount not only when compared to the significant increase of tender prices, but also when compared to the time and efforts spent on remedial measures.

## **Conclusion**

The media has so far tended to focus on whether UN-HABITAT made unjustified payments to local authorities and whether the organization lost money through delays in the implementation of the currency clause. Obviously an objective answer to this question must await the conclusions of the Volcker Commission and the agency will work on them seriously. In the meantime, UN-HABITAT does not consider itself to have caused any losses or to have mismanaged the programme in Iraq. As regards the so-called loss of \$625,000 paid out to local authorities, UN-HABITAT does not consider these as losses, because, in an accounting sense, it was a rightful subsistence allowance paid out to local actors to offset their costs while undertaking an important verification function in implementing the programme at the request of the agency. In an economic sense, these payments translated into investments that generated an incentive system for local actors to take ownership of activities intended to benefit them. This philosophy underpins any enlightened sustainable stabilization and reconstruction effort and UN-HABITAT has extensive experience in this regard not only in Iraq, but also in Kosovo, Afghanistan, Somalia, Democratic Republic of the Congo (DRC), and other afflicted areas in which it operates. It is now widely acknowledged that the inclusion of beneficiaries and local actors in the course of implementation of reconstruction programmes has high payoffs.

The other matter that has attracted media attention that warrants clarification is the claim by OIOS that if the currency clause would not have been removed there could have been potential financial losses of a further \$10 million. This hypothetical projection did not occur, and as verified by OIOS, only \$1.7 million was paid out during the implementation of the recommendation as discussed above. UN-HABITAT wishes to underscore that not only did this hypothetical loss not occur, but also to emphasize that any perceived gains as a result of removing the clause must be discounted against the escalation in tender prices by up to 40% that followed the implementation of the recommendation as observed earlier.

UN-HABITAT believes that the issues clarified here will be helpful to the continuing work of the Volcker Committee and stands ready to provide further clarifications as might be required.

UN-HABITAT also wishes to thank those donors who have recognized the agency’s extensive experience in Iraq and have provided resources that have allowed UN-HABITAT to resume its activities as part of the current international efforts to stabilize and reconstruct Iraq and to assist the Iraqi people.

## **UN-HABITAT Iraq Programme as of January 2005**

In line with its Urban and Housing Rehabilitation Programme for Iraq (UHRP), UN-HABITAT continues to actively participate in the reconstruction of Iraq through physical rehabilitation activities as well as policy and institutional reform, and training and capacity building. This programme is being implemented as part of the overall UN Strategic Plan for Iraq by UN-HABITAT working out of offices in Amman, Jordan and Kuwait. In late 2003, UN-HABITAT established the High-Level Advisory Panel for the Reconstruction of Iraq with a multi-disciplinary membership of distinguished Iraqi professionals, academics, and government

officials, including the Ministers for Municipal and Public Works, Housing and Construction, and Planning and International Cooperation. The Panel guided UN-HABITAT in the formulation of the Urban and Housing Rehabilitation Programme (UHRP) for Iraq. It has ensured that this programme enjoys full Iraqi ownership and support. The UHRP focuses on capacity building and reform in housing and housing finance, slum upgrading and strengthening the construction sector, as well as municipal management, and urban information systems. Implementation of the UHRP started in mid-2004 through two projects financed by the UNDG Iraq Trust Fund. The High-Level Advisory Panel assists UN-HABITAT with continued advice and monitoring of the projects. UN-HABITAT is the only UN agency with current activities in Iraq that has established such an advisory panel.

The Government of Japan is presently the largest partner of UN-HABITAT in Iraq, with total approved funding mainly through the Iraq Trust Fund of US\$ 42.4 million for the projects *Rehabilitation of Schools, Community Rehabilitation, Educational Facilities Rehabilitation*, and the *Living Infrastructure and Community Rehabilitation* project. These projects, as well as the *Rehabilitation of School Buildings in the Lower South* supported by US\$5.2 million from the Iraq Trust Fund, are being implemented in the central and southern region of Iraq in close cooperation with Iraqi authorities and communities, primarily in and around Samawa and Basra.

The projects *Strengthening the Capacity of the Housing Sector* and the *Strengthening the Urban Sector through Building Capacities in Municipal Planning and Management* are also funded from the Iraq Trust Fund with US\$ 14.6 million and represent the first phase of the UHRP. Under these projects, UN-HABITAT is engaged in an intensive programme of capacity building, training and policy development to assist the people of Iraq in their efforts to reconstruct their society and livelihoods.

### **Further background information about the SRP**

Beyond physical reconstruction, and consistent with the UN-HABITAT's mandate of linking humanitarian intervention with longer term development, the SRP significantly improved the socio-economic situation in northern Iraq by involving and supporting low-income communities and building the institutional capacity of local authorities (LAs). UN-HABITAT engaged in a constant policy dialogue with the LAs, conducted vital baseline surveys and studies, and involved the LAs in project planning and formulation, as well as in construction management and quality control through joint inspection teams.

When the SRP first came on stream mid-1997, one of the most formidable constraints was the limited capacity of the construction sector in northern Iraq, with less than 15 registered contractors, lack of modern construction equipment and, due to the economic sanctions, very short supply of even basic construction materials. As part of a deliberate strategy to bring about a vibrant construction sector, UN-HABITAT packaged projects into small contracts that would be within the capacity of small contractors, developed an effective contractor database as a decision-support system for bidder selection, and established an elaborate construction supervision team to provide permanent support to contractors at more than 2000 sites.

In the end, more than 900 contractors were registered, some of which had grown from small to medium-size, while others had diversified into the manufacture and supply of building materials. Over the course of the SRP, the construction industry became the dominant source of economic activity and job creation in a marginalized region that had been struggling with poverty and widespread unemployment. At its peak between 2001 and early 2003, it is estimated that the SRP resulted in the creation of over 80,000 jobs.

By the time the SRP was handed over to the Coalition Provisional Authority (CPA), the value of physical works fully and partially completed was US\$ 275 million and US\$ 41 million respectively. Contractual obligations of US\$ 108 million and materials and plants of US\$ 38 million were transferred to the CPA. In her letter of 25 June 2003 to Ambassador Paul Bremer, the Executive Director of UN-HABITAT highlighted the achievements of the SRP as the second largest relief and development activity under the OIP in northern Iraq.

**Attachments:**

Table 1 – Status of OIOS Open Recommendations

Annex 1 – UN-HABITAT Response to Matrix attached to the IIC Briefing Paper dated 9 January 2005

**Table 1****Status of OIOS Open Recommendations**

	HAB	Date	Total (TR)	Accepted (A)	Not Accepted (NA)	Withdrawn (W)	Implemented (I)	Balance (B)
AF/2000/101/1	I	05-Jan-2001	18	18	0	4	14	0
AF2001/32/2	II	26-Feb-2002	27	27	0	3	24	0
AF 2002/24/1	III	30-Jun-2003	43	40	3	2	39	2
AF 2003/93/1	IV	24-Jul-2003	10	10	0		10	0
AF/2002/24/2	V	25-Nov-2002	32	32	0		32	0
<b>Total</b>			<b>130</b>	<b>127</b>	<b>3</b>	<b>9</b>	<b>119</b>	<b>2</b>

**Open Recommendations**

2002/24/1/015 OIOS recommends that UN Habitat determine the responsibility and accountability for the delayed implementation of the critical OIOS recommendation on the exchange fluctuation clause

2002/24/1/033 Determine responsibility for not implementing the previous OIOS recommendation to cease payment of allowances to Local Authorities

## Annex 1 – UN-HABITAT Response to IIC Briefing Paper dated 9 January 2005

IIC Ref	OIOS Assignment ID	Title	IIC Summary of OIOS Findings and Recommendations	OIOS Report Date	UN-HABITAT Response
26	AF00/101/1	<p><i>Audit of the UNCHS Settlement Rehabilitation Programme in Northern Iraq</i></p> <p>Audit of <b>UN-Habitat Operations in Iraq</b> including assessment of the efficiency and effectiveness of local contractor procurement procedures, project monitoring and evaluation of completed projects.</p>	<p>Finds significant irregularities in the hiring and evaluation of contractors. Notes that UN-Habitat does not conduct any systematic review of contractors' qualifications and relies on lists provided by local authorities. Adds that a comprehensive mechanism for evaluating contractor performance has not been established and that there has been little segregation of duties by field offices overseeing procurement activities. Questions cash payments of \$500,000 per year to building inspectors who do not provide any services to UN-Habitat. Advocates the establishment of a professional procurement section.</p>	05/01/2001	<p><u>Recommendation Closed OIOS Report AF00/101/1 of 5 Jan 2001</u> UN-Habitat had improved its roster of contractors. Data Base of all contractors was maintained in the Core Team Office, and the contractors' evaluation system was improved in all field offices.</p> <p>In 1998 the Local Authorities (LA) refused to accept completed projects because they felt that they were not involved in the quality inspection process. The inspection function in every country belongs to the relevant government institution and the LAs had no funds to dispatch their inspectors to the field. Accordingly <i>UN-HABITAT</i> paid inspectors participating in joint inspection teams in the form of local per diems, based on actual field visits and as part of the monitoring process. Payment of per diems to Local Authorities personnel was a standard practice of UNOHCI and all UN Agencies working in Iraq at that time. As such, any decision on the part of UN-HABITAT to discontinue it should have been part of a common UN approach.</p>
27	AF01/32/2	<p><i>UNCHS Settlement rehabilitation project in Northern Iraq</i></p> <p>Audit of the <b>contract tendering and contract management procedures</b>, as well as financial and administrative procedures at UN-Habitat.</p>	<p>Reports that appropriate procedures have not been established to determine claims for liquidated damages. Notes that payments to contractors are often made through third-party bank accounts without the formal agreement of contractors. Determines that cost estimates prepared by UN-Habitat to assess bids were not based on verifiable data. Also determines that contract procurement procedures had numerous irregularities, including a lack of clear written guidelines or provisions for the segregation of duties, and were often based on competition among an insufficient number of contractors.</p>	26/02/2002	<p><u>Recommendation Closed OIOS Report AF2001/32/2 of 26 Feb 2002.</u> The recommendation (AF01/32/2/002) reads: "Strengthen procedures to ensure that liquidation damages are charged to contractors where appropriate". In response to this recommendation UN-HABITAT strengthened the established procedures.</p> <p>1. Due to the sanction The Oil-for-Food Programme did not allow payments inside Iraq. There were also no official banking facilities in North. Most local contractors did not have accounts in foreign banks nor the possibility of establishing foreign accounts. The usage of the third party bank accounts was on request of the contractors, who had gone into private arrangement with other larger contractors who had</p>

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					<p>offshore accounts. Contractors were required to provide a signed payment request providing the banking detail before payments were effected. Under the circumstances this was the most satisfactory arrangement. Insisting on each contractor having an offshore account would have resulted in disqualifying most of the local contractors in the region, thus defeating UN-HABITAT's objective of build the capacity of smaller contractors. UN-HABITAT built the capacities of the local construction industry from only 15 to 900 contractors.</p> <p>2.UN-HABITAT agency estimates were always done by qualified surveyors. UN-HABITAT continuously compared its data with other UN Agencies. Data collection and verification was a challenge given the realities on the ground at the time. In the absence of officially verifiable data, UN-HABITAT established procedures to track building material prices and labour costs, to arrive at best possible cost estimates.</p> <p>3.UN-HABITAT always followed UN Procurement Rules &amp; Regulations. A procurement procedures manual was prepared providing clear guidelines</p> <p>4.The number of contractors invited to tender ranged from 8-12 in accordance with UNON's recommendations.</p>



IIC Ref	OIOS Assignment ID	Title	IIC Summary of OIOS Findings and Recommendations	OIOS Report Date	UN-HABITAT Response
28	AF02/24/2	<p><i>Audit of procurement of construction and other equipment</i></p> <p>Audit of <b>procurement activities related to construction activities</b> at UN-Habitat.</p>	<p>Reports lack of systematic physical verification system for procured construction items and notes errors in inventory listing. Also reports inefficient use and non-use of generators procured to pump water. Notes various inefficiencies and gaps in maintenance and disposal of construction equipment. Also notes erratic contract management and non-renewal of certain contracts after their respective expirations. Determines that UN-Habitat rarely prepares procurement plans for equipment and does not routinely coordinate with other agencies such as UNDP. Observes that procurement requests should be “generic in nature” but in practice often specified particular brands.</p>	25/11/2002	<p>UN-HABITAT deliberately used regular internal audit as a management tool to guide the programmes being implemented to enhance of transparency, accountability and efficiency. Operating procedures were constantly reviewed and improved in line with recommendations from the OIOS. All audit recommendations were reviewed and implemented accordingly.</p>
29	AF02/24/1	<p><i>Management Audit of UN-Habitat Settlement Rehabilitation Programme (SRP) in Northern Iraq.</i></p> <p>Audit of the implementation of the <b>delegation of procurement authority</b> and related procedures at UN-Habitat.</p>	<p>Describes a “situation of mismanagement” resulting in a loss of over \$2 million that could grow to more than \$12 million. Determines that the failure to remove a currency fluctuation clause from construction contracts led to losses of \$1.7 million. Also determines that in 2001-02 local authority personnel not employed or providing services to UN-HABITAT were paid \$625,000. Criticizes the bidding process for construction contracts. Sharply criticizes UN-Habitat’s failure to implement 34 out of 45 previous audit recommendations. Notes numerous other operational failures. States that the issues discussed in the report require “urgent attention.”</p>	30/06/2003	<p>1.The Office of the UN Treasurer recommended the currency adjustment clause in 1998. It was introduced under the advice and guidance from UNON and UNOHCI as a measure to protect the small local contractors against losses due to currency fluctuations. Under the clause, contractors had to absorb up to 10% of fluctuation, while UN-HABITAT absorbed fluctuations between 10 and 30%. As the clause worked both ways, UN-HABITAT initially benefited and construction costs remained low. UN-HABITAT paid a total of US\$ 1,7 million under the clause to some 145 contractors, less than 1% of the total implemented project volume of US\$ 353 million. UN-HABITAT does not, therefore, consider that money was lost as a result of this clause. After the audit, instructions for the discontinuation of the clause were given to the CTA in Arbil. The delay in removing the clause was caused by the need for UN-HABITAT to create alternative remedial measures to reduce the currency risks for the contractors in order to avoid a drop or even a stoppage in construction activities. Even</p>

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					<p>with these remedial measures, there were still a number of strikes by contractors as they felt the risks were too high. The cost increase of US\$ 1.7 million is a very limited amount compared to the significant increase of tender prices after the clause was removed in 2002, and the time and efforts spent on remedial measures. This OIOS recommendation fails to grasp the reality on the ground in Iraq at the time.</p> <p>2. In 1998 the Local Authorities (LA) refused to accept completed projects because they felt that they were not involved in the quality inspection process. The inspection function in every country belongs to the relevant government institution and the LAs had no funds to dispatch their inspectors to the field. Accordingly <i>UN-HABITAT</i> paid inspectors participating in joint inspection teams in the form of local per diems, based on actual field visits and as part of the monitoring process. Payment of per diems to Local Authorities personnel was a standard practice of UNOHCI and all UN Agencies working in Iraq at that time. As such, any decision on the part of UN-HABITAT to discontinue it should have been part of a common UN approach</p>
30	AF03/93/1	<p><i>UN-Habitat Settlement Rehabilitation Programme processing of payments of interim and final invoices for construction contracts</i></p> <p><b>Audit of payments processing function at UN-Habitat</b></p>	<p>Reports discrepancies in database tracking system and advocates improvements in the system's integrity and reliability. Recommends the formulation of procedures to handle and process the bulk receipt of invoices. Advocates random verification of invoices to ensure proper calculations and adherence to contract terms. Notes \$256,420 in "outstanding unliquidated obligations."</p>	24/07/2003	<p>1. The few minor discrepancies noted were due to typographical errors made in the transfer of data from the manual logbook to the electronic tracking spreadsheet.</p> <p>2. Processes had been set up to ensure that there were minimum delays in invoice payments through continuous exchange of information between the field office, Headquarters and UNON Finance Department.</p> <p>3. The amount of \$256,420 in "outstanding unliquidated obligations" related to payments withheld during the retention periods. These payments were only released to contractors after satisfactory completion of work. This is a common practice in any construction project. All audit recommendations were reviewed and implemented accordingly.</p>

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