UNITED NATIONS NATIONS UNIES

INTERNAL AUDIT DIVISION
OFFICE OF INTERNAL OVERSIGHT SERVICES

Reference: AUD-7-4:11 (328 /02)

26 February 2002

To: Ms. Anna Tibaijuka, Executive Director
United Nations Centre for Human Settlement (Habitat)

Mr. Alexander Barabanov, Chief
Division of Administrative Services, UNON

From: Esther Stern, Director
Internal Audit Division, OIOS

Subject: **OIOS Audit No. AF2001/32/2: UNCHS Settlement Rehabilitation Programme in Northern Iraq**

1. I am pleased to present herewith our final report on the subject review, which was conducted in Northern Iraq in September 2001.

2. We note from your response to the draft report that Habitat has generally accepted the recommendations. Based on the response, we are pleased to inform you that we have closed recommendations 2, 5, 10 to 14, 19 to 24, and 26 and 27 in the IAD recommendation database. In order for us to close out the remaining recommendations - recommendations 1, 3, 4, 6 to 9, 15 to 18, and 25 - we request that you provide us with additional information as indicated in the text of the report and a time schedule for implementing each of the recommendations. Please refer to the recommendation number concerned to facilitate monitoring of implementation status.

3. IAD is assessing the overall quality of its audit process and kindly requests that you consult with your managers who dealt directly with the auditors and complete the attached client satisfaction survey form.

4. I take this opportunity to thank the management and staff of UN Habitat for the assistance and cooperation provided to the auditors in connection with this assignment.

CC: Mr. J. Connor
Mr. J.P. Halbwachs
UN Board of Auditors
Ms. H. Thorup-Hayes, OIOS
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United Nations
OFFICE OF INTERNAL OVERSIGHT SERVICES
Internal Audit Division

Audit Report

Audit subject: UNCHS Settlement Rehabilitation Project in Northern Iraq

Audit No. AF2001/32/2

Report date: 26 February 2002

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Audit of the UNCHS Settlement Rehabilitation Project in Northern Iraq
(A2001/32/2)

Executive Summary

In September 2001, OIOS conducted an audit of the United Nations Centre for Human Settlements (Habitat) Settlement Rehabilitation Programme in Northern Iraq. The primary objectives of the audit were to review and assess the efficiency and effectiveness of contract tendering and contract management procedures, follow up on implementation of previous audit recommendations, and assess the adequacy of financial and administrative procedures.

Results in brief:

- Procedures for assessing liquidated damages to contractors where inconsistent, even though in some cases there was clear indication of delays in completing contracts. Most files reviewed did not contain authorized contract extensions, and liquidated damages had not been assessed. Appropriate procedures had not been established to determine the basis for assessing and charging liquidated damages.

- The currency adjustment clause in the contract provides for adjustments of up to 30 per cent of the contract value, which exposes Habitat to significant risk. The old Iraqi Dinar (OID) used in Northern Iraq may be subject to significant fluctuations, as a result of political factors, resulting in a high risk of financial losses to Habitat.

- Payments to contractors are normally made to third party bank accounts without any formal agreements with the contractors. No attempt had been made to assist contractors with establishing their own account in another country (e.g. Jordan), which had prevented Habitat from paying mobilization advances and in obtaining performance bonds.

- The contract cost estimates prepared by Habitat in order to assess the reasonableness of bids from contractors were not based on verifiable data.

- Contract procurement procedures:

  - Were often based on competition among an insufficient number of contractors;
  - Did not have clear written guidelines established;
  - Did not always ensure that bid documents received were date stamped;
  - Did not provide for adequate segregation of duties; and
  - Disqualified bids that did not fall within plus or minus 10 per cent of the agency estimate.

- Authority to procure goods and services has recently been delegated to Habitat Northern Iraq. Lines of authority, which included the Chief Technical Adviser (CTA), the Chief of the Baghdad Liaison Office and UNON's procurement section, did not provide for clear

accountability. Moreover, the delegation of authority has been established at $1 million (from phase II of the delegation), which may be excessive considering current contract values.

- Project documents were of a general nature and did not indicate specific types of projects, their location, and the estimated cost, making it difficult to monitor the implementation of the approved programme. Furthermore, contracts were not linked to approved projects, which may result in contracts being entered into which are not in accordance with the project document.

- Hazard pay was being paid at a flat rate of $1,000 per month without deductions for days absent from the hazardous area. This resulted in overpayments of approximately $45,000 for 2000 and 2001. While the UN Office at Nairobi (UNON) had been aware of the overpayments, no action had been taken to stop them.

- Various administrative issues for the Core Team and Erbil Field office included:

  - Slow implementation of measures to improve cash handling procedures;
  - No significant improvement in cash management procedures;
  - Need to improve the physical security of cashier's office in the new Core Team and Erbil field offices;
  - Inadequate property management procedures; and
  - Lack of implementation of previously accepted audit recommendations.

Major recommendations:

- The currency adjustment clause in construction contracts should be deleted and contractors advised of the change in order to avoid potential additional payments by Habitat of up to 30 per cent of the contract value, which could affect Habitat's ability to continue operations in Northern Iraq.

- Contractors should be required to indicate in bid submissions the timeframe for completion of the project. Furthermore, procedures need to be strengthened to ensure that liquidated damages are charged whenever applicable.

- In order to reduce payments to third party bank accounts, Habitat should consider assisting contractors with establishing bank accounts in a third country (e.g. Jordan) which would also enable Habitat to obtain performance bonds, pay mobilization advances and provide more efficient processing of payments.

- With procurement authority having recently been delegated to Habitat Northern Iraq, there is a need to establish a procurement section to be responsible for all procurement aspects, including tenders for construction contracts, in order to improve segregation of duties.

- The $1 million level of procurement authority delegated to Habitat Northern Iraq should be reduced to a more realistic level given that very few contracts are of this value.

- A system should be developed to link construction contracts to approved projects for each phase of the programme in order to strengthen monitoring of project implementation.

- Hazard pay should only be paid for days staff members are working in hazardous areas in accordance with hazard pay rules. Amounts overpaid should be identified and recovered from staff members. Furthermore, UNON should determine accountability for the breach of hazard pay rules.

- Further effort is needed to implement accepted audit recommendations in critical financial and administrative areas.

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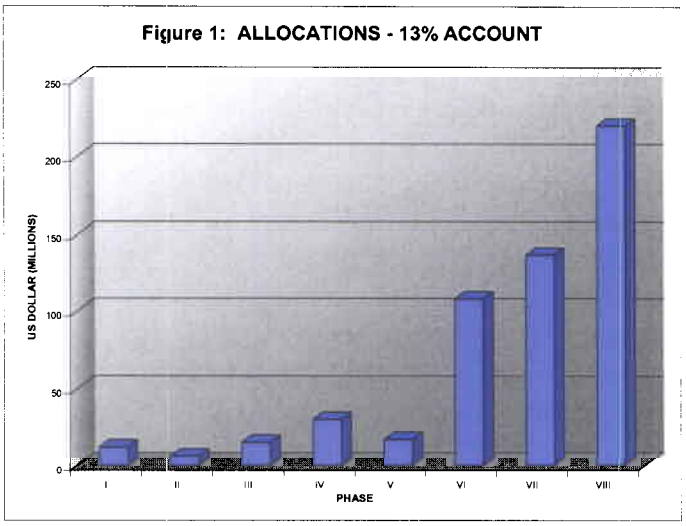
I. INTRODUCTION

1. In September 2001, OIOS conducted an audit of the United Nations Centre for Human Settlements (Habitat) Settlement Rehabilitation Programme in Northern Iraq. The audit was performed in accordance with the general and specific standards for the professional practice of internal auditing in United Nations organizations.

2. Habitat is one of nine UN organizations implementing projects in various sectors funded under Security Council Resolution (SCR) 986 (1995). In the Memorandum of Understanding (MOU) between the Secretariat of the United Nations and the Government of Iraq (GOI) on the implementation of SCR 986 (1995) the GOI undertook to distribute equitably to the Iraqi population humanitarian supplies purchased with the proceeds of the sale of Iraqi petroleum and petroleum products under the oil for food programme. Thirteen per cent of the oil revenues are allocated to Northern Iraq under this programme.

3. The primary purpose of the Habitat Iraq project, which commenced in June 1997, is to rehabilitate and resettle internally displaced persons in the northern Iraq governorates of Erbil, Dohuk and Sulaymaniyah. The project comprises the following sectors: housing and shelters (32%); education (27%); health (6%); water and sanitation (16%); access roads and bridges (14%); and agricultural services and public services (5%).

4. Figure 1, shows allocations to Habitat up to phase VIII of the programme, which ended on 3 December 2000. In addition, Habitat is provided with funding from the 2.2 per cent account for operating cost such as salaries, equipment and supplies, mission travel, etc.



5. The Project headquarters, referred to as the Core Project Management Team (Core Team), is located in Erbil. The three field offices are located in Erbil, Dohuk and Sulaymaniyah. In addition, there is an administrative office in Amman, Jordan and a liaison office in Baghdad to coordinate activities with UNDP, UNOHCI and the GOI.

6. The findings and recommendations contained in this report were discussed with Habitat project management in Northern Iraq and, subsequently, with Habitat officials in Nairobi who were provided with a summary of the major findings during the exit conference. An audit observation concerning the currency adjustment clause in construction contracts was issued to the Chief Technical Adviser (CTA) subsequent to the audit. Habitat management's comments on a draft of this report are reflected in the report as appropriate and are identified in italics.

II. AUDIT OBJECTIVES

7. A preliminary risk assessment of the Project found that there is a need to focus on process risks in the areas of operations and technology. The current audit focused on operational aspects including contracting activities. We also followed up on implementation of recommendations from the previous audit (Assignment no. AF2000/101/1). The overall objectives of the audit were to:

i. Review and assess the efficiency and effectiveness of contract tendering and management procedures;
ii. Assess implications of the procurement delegation of authority;
iii. Follow up on implementation of previous audit recommendations; and
iv. Review adequacy of financial and administrative procedures.

III. SCOPE

8. The audit focused on tendering procedures for construction contracts and contract management, and financial and administrative procedures. Our review consisted of examining books and records, and contract documentation such as contracts, tender documents and interim invoices. In addition, we interviewed senior Core Team officials in Erbil and key field office staff. We also visited the Erbil and Sulaymaniyah field offices to review tendering and contract management procedures. An audit programme for construction contract audits and a separate audit programme for financial and administrative areas were used.

IV. AUDIT FINDINGS AND RECOMMENDATIONS

A. Contract management issues

The contract currency adjustment clause could result in significant financial losses

9. All construction contracts entered into by Habitat include a clause to compensate or penalize contractors for up to 30 per cent of the contract price due to fluctuations in the exchange rate between the US dollar and the local old Iraqi dinar (OID). As a result of this clause, Habitat is exposed to potential losses, as well as gains, of up to 30 per cent of the contract value. If this should occur, it would seriously affect the continuing operations of Habitat's programme in Northern Iraq.

10. The invitations to tender (ITT) solicited quotations in US dollars and the contractors quote the total amounts in US dollars. Moreover, the contract price is in US dollars and nowhere in the contract or other documents such as ITTs is there any mention of other currencies. Payments for the contract are also effected in US dollars. Additional payments made by Habitat due to exchange rate fluctuations to date were $200,517. It was also ascertained that $378,333 were deducted from contractors as a result of favourable fluctuations.

11. The UN had not established an exchange rate for the OID and there are no banking facilities in Northern Iraq that establish exchange rates, which is done on an informal basis by local merchants.

Hence, there is considerable scope for currency manipulation. Furthermore, new OID notes are no longer being printed, which also makes it susceptible to volatile fluctuations. It is also against normal practice for the UN to compensate the contractors for currency risks. Moreover, the US dollar is an international reserve currency and would protect the contractors in times of uncertainties.

12. The matter was discussed with the CTA who had not seen any policy or authorization or guideline on the issue. In his opinion, if Habitat does away with this clause, contract prices might increase. Considering these facts, OIOS sees no reason why Habitat should absorb the risk of currency fluctuations.

Recommendation no. 1

Habitat should amend the standard construction contracts by deleting the exchange rate fluctuations clause that provides compensation to contractors in order to avoid potential liabilities to Habitat (AF01/32/2/001).

13. *Habitat management agreed with the recommendation and indicated that "measures will be taken to implement the recommendation."* We would appreciate being informed of the measures to be taken and their planned implementation date in order to close the recommendation.

Control over assessing liquidated damages needs to be strengthened

14. Habitat construction contracts provide for the payment of liquidated damages amounting to 0.2 per cent of the contract value for each day of delay in completing the contract with a maximum amount of 10 per cent. We analyzed the contract database and found that in the majority of cases, the actual completion date exceeded the contractual completion date. We also found that liquidated damages amounting to $376,695 had been charged primarily in the early phases (phase I to IV) of the programme. However, in recent programme phases, the amount of liquidated damages charged had decreased significantly. A procedure had been established which required authorization to extend the contract date. Unless there was an authorized extension to the contract liquidated damages should have been assessed.

15. Our review of sample contracts found that there were many instances where liquidated damages had not been charged. Furthermore, justification for not charging liquidated damages was not always documented in the contract file and, in some cases, the justification given did not appear realistic or appeared to be contradictory to other evidence on file. Management had not established appropriate procedures and controls to ensure that liquidated damages are charged to the contractor. In many instances, management had accepted explanations provided by the contractor even though these had not been plausible and in other cases, management had tended to overlook delays in contract completion. In our view, the contract terms and conditions should be adhered to and liquidated damages charged whenever appropriate. Contract management procedures need to be put in place to ensure that liquidated damages are charged in all applicable instances.

16. Our review of liquidated damages in Sulaymaniyah and Erbil found that contract files reviewed (Figure 2) did not contain approvals for all time extensions, which should have resulted in liquidated damages being charged. Subsequent to the audit, management provided us with documentation indicating that time extensions had been approved for most of the contracts reviewed. However, these documents were not on file during our review. Moreover, as shown in Figure 2, there were clear indications on file showing slow implementation by contractors that would tend to support the conclusion that liquidated damages should have been charged. In our view, appropriate procedures had not been established to adequately review the reasons for delays in completion of projects. Furthermore, there are no standard operating procedures to ensure that delays are reviewed and adequate justification obtained. A list indicating valid reasons for not charging liquidated damages was also not available. It did not appear to have been a priority to charge liquidated damages.

Figure 2: LIQUIDATED DAMAGES - SULEIMANIYAH

Contract no.	Days delay	Days approved	Liquidated damages to be charged (days)	Amount not charged ($)	Comment
SUL/CON/ 141	185	75	110	4,643	Extension not approved by Field Coordinator
SUL/CON/ 161	304	43	261	17,390	Liquidated damages not charged
SUL/CON/ 179	92	92	0	0	Justification not clear
SUL/CON/ 184	92	0	92	5,850	Request for extension not accepted by Habitat
SUL/CON/ 91	226	0	226	10,105	No liquidated damages charged
SUL/CON/ 92	220	75	145	16,603	Balance of liquidated damages not charged
ERB/CON/ 57	9	9	0	0	Nine days extension was awarded post facto. No approved extension reports submitted during project implementation.
ERB/CON/ 164	146	146	1	285.27	Approval of 21 days granted post facto despite previous correspondence citing bad management for delay and indication that liquidation penalty will be charged.
ERB/CON/ 166	198	181	17	4,930	Earlier letters to the contractor, dated 6 February and 12 May 2001, reminded the contractor of the date for liquidating damages. Liquidated damage not paid.

ERB/CON/ 169	260	260	0	0	A 90-day extension was granted for 200 days (including two months for Variation Order approval).

17. The fact that most construction contracts were not completed within the contractual period indicates that tendering documents prepared by Habitat do not always accurately reflect a realistic completion date and take into account all conditions faced by the contractor. In order to avoid this situation, it may be appropriate for the ITT to include a request for the bidders to provide a completion date as part of the bidding process. This would also provide a better basis for determining if liquidated damages should be assessed, and would provide an additional basis for awarding contracts. The bidder should take such things as climatic conditions, which is one of the main reasons for time extension requests, into account when submitting bids. Furthermore, there is a need to provide both justification and the cost implications of contract extensions on the contract extension request form in order for both the project manager and the CTA to be aware of the additional costs of the contract.

Recommendation nos. 2, 3 and 4

Habitat Northern Iraq should:

(i) Strengthen procedures to ensure that liquidated damages are charged to contractors where appropriate in accordance with the contract. Where it is decided not to charge liquidated damages, full justification should be documented in the contract files for reference, and approval not to charge them should be made by the project manager or CTA. (AF01/32/2/002);

(ii) Amend the ITT to request that bidders provide a contract completion date, which should be included as a factor in the bid evaluation process. Bidders should also be informed that liquidated damages will be applied unless verifiable valid reasons for time extensions are provided and approved by Habitat (AF01/32/2/003); and

(iii) Indicate on the request for extension form the financial implication of the extension, based on the contract formula, requested by the contractor in order for the approving officer to determine the cost of the extension to the contract (AF01/32/2/004).

18. *Regarding recommendation 2, Habitat management agreed with the recommendation and indicated that it has taken provisions to strengthen the enforcement of liquidated damages.* The recommendation has been closed. *Recommendation 3 was agreed to and Habitat stated that it would include an execution period in tenders/contracts to be proposed by bidders.*
Recommendation 4 was agreed to and will be implemented in conjunction with recommendation 3.

Recommendations 3 and 4 will be closed once we have been provided with the revised tenders and contracts.

Construction contract payment procedures

19. Due to a lack of banking facilities in Northern Iraq, Habitat has been making contract payments to third party accounts according to instructions provided by contractors. These accounts are generally not in the name of contractors or their companies. In many cases, this arrangement has led to payment delays to the contractors of more than two months. The Project Manager in Sulaymaniyah also informed us that delayed payments have an impact on the delivery of the programme, since the financial capacity of contractors in Northern Iraq are limited and they rely on prompt payment to finance contract activities. We also found that there is no legal agreement between Habitat and contractors for this arrangement.

20. The matter was discussed with the CTA who generally agreed that Habitat should explore the possibility of assisting contractors to open accounts in their own name. In our opinion, Habitat should therefore explore the possibility of assisting contractors to establish bank accounts in another country, for example Jordan, possibly with the assistance of the UNDP office. This would greatly facilitate payments to contractors and also allow Habitat to establish performance bonds. It would also be favourable to contractors who could request "mobilization" advances against the bank guarantees. This would go some way towards increasing the programme implementation rate.

Recommendation nos. 5 and 6

Habitat should:

(i) Enter into a legal agreement with contractors, stipulating details of payments to third parties, before making any further payments to other than the contracting party (AF01/32/2/005); and

(ii) Review its payment procedures and assist contractors to open bank accounts in a third country, which would simplify the payment process and enable Habitat to establish performance bonds and pay mobilization advances where appropriate (AF01/32/2/006).

21. *Habitat agreed with recommendation 5 and based on their comments this recommendation has been closed. Recommendation 6 was also accepted.* In order to close this recommendation management should provide us with details of how they plan to implement it and action taken to obtain performance bonds from contractors.

Contractor selection issues

22. Our review of procedures to select construction contractors in the Erbil and Sulaymaniyah field offices revealed a number of weaknesses, which affected the impartiality and transparency of the

contractor selection process. In our view, this could be avoided by establishing a separate centralized procurement unit and standard operating procedures for the selection process. We reviewed contracts in the Erbil and Sulaymaniyah Field Offices and noted the following discrepancies and weaknesses:

- At least eight contracts examined in the Erbil Field Office were awarded to the second lowest bidder without adequate justification on file.

- In the Erbil Field Office, several bidding receipt forms lacked the signature of the receiver and date. In Sulaymaniyah, several bids had not been stamped with the receipt date and time making it uncertain whether they had been received before the bid opening.

- Although there is a formula for the rating of contractors, other contractors are sometimes added to complete the list even though they do not meet requirements. Management indicated that there are sometimes shortages of contractors necessitating this practice.

- In a case where a second re-tendering was done in the Erbil Field Office, a specific company was recommended by the Field Officer for inclusion on the basis that the company was already working on a project in the same area. The company was subsequently awarded the contract as the lowest bidder.

- The agency contract estimate, used as a basis for evaluating bids, was based on data which was not verifiable and a questionable methodology. Hence, there is no valid basis for relying on this estimate as a contractor selection tool.

- In the Erbil Field Office, a project that was subdivided into five different contracts, which were tendered separately, one contractor tendered the lowest bid for the two biggest projects. In one of the bids, the next lowest bid was greater by $500. Considering that the projects were implemented concurrently, resources of the winning bidder were strained resulting in delivery delays. In a separate case, one ITT was issued giving four days to respond contrary to the 15 day requirement.

- In the Erbil Field Office, not all bids tendered are filed as part of the Contract File. It was explained that the practice is to file the three lowest bids but even this was not always done.

- In the Erbil Field Office, the contract status report shows that 49 projects had been authorized for tender, but only six were actually tendered due to the shortage of contractors. There were 21 contract proposals awaiting authorization from Nairobi at the time of the audit.

- Changes to documents are done in ink after using correction fluid to erase errors, and the officer making the change does not initial such changes.

- The Sulaymaniyah Field Office normally invites seven bids for each tender. In doing this, it is guided by the listing and categorization provided to it by the local authorities (LA). There is no documentation as to why specific contractors had been invited for a bid. We were informed that previous work and a judgement decision as to whether a contractor is able to handle additional work guided the decision. The whole system of pre-selection of bidders was not transparent and we could not find any written guidelines or policies for this process.

23. In our opinion, the above weaknesses and discrepancies had a material effect on the contractor selection process and did not provide adequate assurance that the lowest bidder has been awarded the contract, or that the procedures have provided fair and open competition among contractors. In view of this, it is essential that Habitat Northern Iraq management take urgent action to strengthen the contractor selection process.

24. We were also concerned that there was no plan to establish a procurement section in the Core Team, which would be responsible for contractor selection in line with established procurement policies. This also contradicts the procurement delegation of authority. While this would involve some obstacles in the procurement process due to the distance of the Core Team office from field offices and the lack of free movement of contractors between governorates, we are of the opinion that establishing a procurement section with clear responsibilities is essential in order to establish adequate segregation of duties. The section should be independent from planning or implementation units and supervised by qualified international staff.

25. In light of the recent delegation of procurement authority, procedures need to be developed for determining bidding procedures, receipt of bids and opening, how bids will be sent to the Core Team for recording, a methodology for evaluation of bids and procedures for notifying vendors of successful bids. Currently, the field offices are fully responsible for all aspects of tendering procedures. This has not provided the required degree of internal controls and segregation of duties. Clearly, there is a need to establish adequate working practices in this regard.

Recommendation nos. 7, 8, 9, 10 and 11

Habitat Northern Iraq should:

(i) Establish a procurement section to issue ITTs, receive bids and record, maintain the vendor roster, award bids and prepare contracts (AF01/32/2/007);

(ii) Establish standard operating procedures for the contractor selection process to ensure that all field offices follow the same procedures and policies (AF01/32/2/008);

(iii) Establish consistent and transparent procedures for preparing the agency contract estimate which should include the sources,

analysis and evaluation of the data used, and be approved by the field coordinator or CTA (AF01/32/2/009);

(iv) Ensure that the lowest acceptable bidder is awarded the contract and that any reasons for rejecting the lowest bidder is fully justified and documented (AF01/32/2/010); and

(v) Ensure that the ITT is open to all pre-qualified contractors without restricting the number of contractors allowed to bid (AF01/32/2/011).

26. *Habitat agreed with recommendations 7 to 11.* Based on management's comments, we have closed recommendations 10 and 11. *Regarding recommendation 7, a senior procurement officer has been recruited and is establishing a Procurement Unit in the Core Team. In addition, a UN Office at Nairobi (UNON) team from the Contract and Procurement Section will be sent to Iraq to provide further assistance. The response to the draft audit report also stated "...the tasks of receiving bids and their evaluation are performed by appropriately segregated units in the field offices and submitted to the Core Team for review, approval and further processing."* In order to close recommendation 7, we would appreciate receiving the results of the UNON team's visit to Iraq as well as details on the organization structure in the field offices to ensure adequate segregation of duties in the procurement process.

27. In order to close recommendation 8, we would appreciate being provided with a copy of the revised standard operating procedures for the contractor selection process. For recommendation 9, we request a copy of the revised procedures for preparing agency contract price estimates.

B. Delegation of procurement authority

28. Recently, Habitat Northern Iraq received delegation of authority to procure goods and services of up to $600,000 in phase I and, in phase II after six months, up to $1 million. While the delegation of authority has still not been fully implemented, we have briefly reviewed certain aspects to determine its possible impact on Habitat Iraq's operations. We found that there are a number of issues that need to be clarified and others that need to be reassessed in order to make the delegation a useful tool to increase the project implementation rate and to provide for adequate internal controls including segregation of duties.

29. In our opinion, the $1 million delegated is excessive since to date there have been few contracts of this amount. In addition, individual contractors' capacity to implement contracts of this value is extremely limited and it would be a risky strategy to do this. We also noted that Habitat in Northern Iraq had not yet established a procurement capacity to handle such contracts. In our view, a chief procurement officer and staff would need to be in place, and sound procedures established before the delegation can be implemented. In our opinion, the procurement limit needs to be reviewed and an appropriate lower limit established.

30. We note that paragraph 3.1 of the delegation of authority states that "the CTA is responsible to the Executive Director UNCHS (Habitat) for all activities of the Settlement Rehabilitation Project in Northern Iraq." However, subsequent sections (e.g. 5.1 (c) (iii)) give signing authority to the Director, Baghdad for awards of over $300,000 and up to $600,000 in phase I, and from $600,000 and up to $1 million in phase II. It is not clear that this mechanism adds any value to the procurement approval process and also tends to dilute accountability of the parties involved. In our view, it would be appropriate to have the CTA held accountable for all procurement actions undertaken by Habitat Northern Iraq.

31. Annex C of the delegation of authority provides for a local committee on contracts (LCC) composed of five members and an observer from UNOHCI. Three of the members are from the field offices and one from the Core Team. While this composition seems reasonable considering the number of staff members available in the Project, there should be a requirement that the requisitioning office not take part in LCC meetings where their cases are being discussed. At such times, they should only be present in a non-voting capacity. It may therefore be necessary to vary the composition of the LCC. In our view, it would also be beneficial for the UNOHCI Northern Iraq Legal Advisor to attend LCC meetings as an observer, since Habitat lacks legal expertise, which is a major impediment to the effective functioning of the LCC. Habitat should also consider appointing its own legal advisor.

Recommendation nos. 12, 13 and 14

OIOS recommends that Habitat:

(i) Review the delegation of procurement authority financial limit of $1 million, with a view to decreasing it, since it may be excessive considering past and expected future contract values (AF01/32/2/012);

(ii) Ensure accountability by making the CTA fully accountable for all procurement decisions within the delegation of authority, and by eliminating the need for the Baghdad office to authorize transactions above a certain limit which we consider an unnecessary step (AF01/32/2/013); and

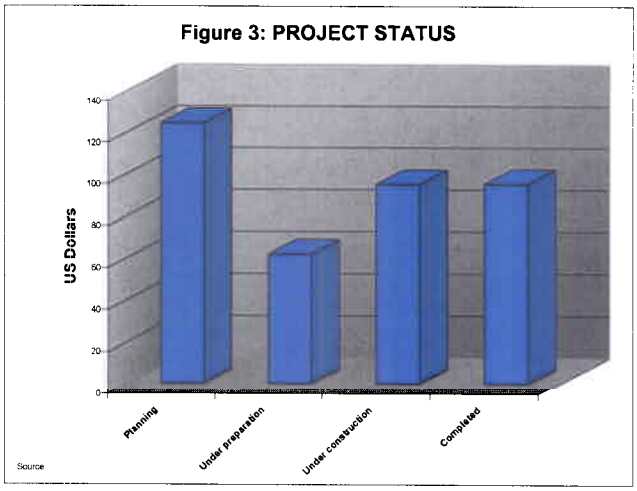
(iii) Request UNOHCI to allow its Legal Advisor to take part in LCC meetings as an observer pending the possible establishment of a legal advisor post in Habitat Northern Iraq (AF01/32/2/014).

32. *Habitat agreed with recommendations 12, 13 and 14 stating that the delegation of procurement authority will be capped at $600,000 instead of the proposed $1 million level.* We have therefore closed these recommendations in the OIOS database and will review the functioning of the delegation of procurement authority during the next audit of Habitat in Iraq.

C. Project management

Project management needs to be strengthened

33. As part of the audit, we reviewed the procedures adopted by Habitat to ensure that only approved projects are implemented under the SCR 986 (1995) programme. Figure 3, shows the current status of Habitat projects in Northern Iraq. We found that a mechanism had not been implemented to ensure that only approved projects are in fact being implemented which leaves open the possibility that contracts unrelated to a specific project can be entered into. Should inappropriate projects be implemented, there could be political ramifications which could damage the reputation of Habitat and UNOHCI. These projects are subject to approval by UNOHCI, which has not yet fully implemented a programme to monitor this aspect of the programme. Furthermore, it would be very difficult for UNOHCI to monitor this aspect, which would depend on accurate information being received from Habitat. It is therefore important that Habitat establish a system to link approved projects for each phase with the contracts entered into to implement the projects.



34. The project documents prepared by Habitat and approved by UNOHCI only have a general description and provide no specific details of specific projects, their location, and cost. While the project document does indicate the total cost of the project, the basis for arriving at this was not mentioned. For example, it was impossible for us to trace a specific contract to a project document except for the phase it belonged to. Essentially, the project document is a financial request for allocation of funds and is the basis on which UNOHCI recommends allocation of funds.

35. While Habitat had not prepared project documents for phase IX onwards, the CTA stated that he is trying to prepare more specific project documents, which would have the necessary details. In our view, this deficiency was caused by the lack of experienced staff and the failure of the Office of the Iraq Programme (OIP) and UNOHCI to insist that project documents have a rigorous and standardized approach. We noted that both Habitat and UNOHCI are attempting to rectify these deficiencies although the pace of change has been slow.

Recommendation nos. 15 and 16

Habitat Northern Iraq should:

(i) Develop a system which links specific contracts with approved project documents in order to ensure that only contracts for authorized projects are implemented and to enable contracts to be traced to the approved project documents. (AF01/32/2/015); and

(ii) Ensure that project documents provide sufficient detail including survey reports, feasibility reports, cost estimates, and break-down in terms of type, location, and the number of houses, beneficiaries, etc. (AF01/32/2/016).

36. *Habitat agreed with recommendations 15 and 16.* Both recommendations concern the project documentation and control process and in order to close these recommendations we request that documentation of the revised procedures be provided to us when completed.

D. Financial and administrative matters

Overpayments of hazard pay to international staff

37. As part of the rules governing the payment of hazard pay, the International Civil Service Commission (ICSC) states that "the eligibility to payment of hazard pay is limited to physical presence in the declared hazardous area; the amount is prorated on a 365-day basis for periods less than one month". However, we found that this allowance has been paid on a flat rate of $1,000 per month and deductions had not been taken for days absent from the hazardous area resulting in overpayments of at least $45,000 for the period from January 2000 to August 2001. Taking into account previous years' overpayments would bring the total considerably higher. We were informed by UNON, which is responsible for payment and ensuring adherence to UN rules, that they were aware of this situation, however, they had not taken any steps to stop the practice resulting in continuing overpayments to Habitat staff.

38. In our view, the failure to correct a known situation resulting in overpayments was a breach of UNON's responsibility to comply with rules and regulations. This situation was exacerbated by the practice of some staff members to take non-certified sick leave while on annual leave and/or in conjunction with occupational recuperation break (ORB) for which hazard pay was also paid. We note that taking uncertified sick leave while on home/annual leave and in conjunction with occupational recuperation break (ORB) is not allowed under the personnel rules.

Recommendation nos. 17, 18 and 19

UNON should:

(i) Take immediate steps to ensure that hazard payments are only made for actual days spent in hazardous areas and conduct a comprehensive review of hazard payments to Habitat staff in order to determine the amount of overpayments and take prompt action to recover them (AF01/32/2/017);

(ii) Determine why a breach of hazard pay rules took place even though the overpayments were known to UNON and determine what accountability measures should be taken (AF01/32/2/018); and

(iii) Take the necessary corrective actions to immediately stop the practice of allowing staff to take non-certified sick leave while on annual leave, ORB, or rest and recuperation breaks (AF01/32/2/019).

39. *Habitat and UNON agreed with Recommendations 17 and 18 concerning lapses in the payment of hazard allowance. The response to recommendation 17 stated "... recovery from the staff that has left Habitat services between January 2000 and May 2001 will be not practically feasible."* However, in our view, Habitat in conjunction with UNON, should review all hazard payments since the start of operations in Iraq (both in Northern Iraq and for the Baghdad office) in order to determine the amount of overpayments made to Habitat staff. Habitat should then determine the location of the staff, even if they no longer employ them, and make an effort to contact them and recover the overpayment. In order to close this recommendation, we request that Habitat provide us with the results of this review, the total amount of hazard allowance overpayments, and the action taken to recover it.

40. *Regarding recommendation 18, the response indicated that UNON only paid hazard allowance "...upon receipt of reports indicating actual days spent in Hazardous areas by project staff."* Based on our review of attendance records for the period January 2000 to August 2001 we found, however, that attendance records contained details of absences from the hazard pay allowance area. UNON should therefore determine why Human Resources Management Service (HRMS) staff did not make appropriate deductions and also provide us with details of the reporting chain responsible for ensuring that deductions were made. Clearly the supervisory mechanism had failed in this instance. In view of this we reiterate our recommendation that UNON inform us of accountability measures that will be taken.

41. *Habitat and UNON agreed with recommendation 19 and based on the comments provided,* we have closed this recommendation in the IAD database.

The cash management function needs improvement

42. A review of the cash management functions at the Core Team and Erbil Offices revealed that there was a general lack of effective cash management policies, and that previous audit recommendations relating to cash management (AF2000/101/1) had not been implemented. Significant cash is at risk - $600,000 to $800,000 could at times be held at the Core Team. The main requirements are clearly stated in the UN Financial Regulations and Rules - Article VIII Custody of Funds and in the UN Finance Manual - Rule 7.061. At the time of the audit, cash held at the Erbil Field Office was over $400,000. The major findings include, *inter alia*:

- Regular cash counts and reconciliation were done by the custodian and independent cash counts were not done by management on a surprise basis;
- No reports were requested by or submitted to management to allow for supervision and monitoring of cash functions;
- Some improvements were made to the cashbook system, however, computerization, controls were inadequate. For example, previously posted entries were deleted resulting in the absence of a transaction audit trail and all transactions were not being reflected;
- The administrative assistants, in both the Core Team and the Erbil Field Office, had not taken official annual vacation leave since commencing employment in 1997 as a result of inadequate staffing resulting in a serious internal control deficiency;
- Providing cash loans to staff (both Core Team and Erbil Office) and holding cash in safekeeping for staff at the Core Team. These transactions were incorrectly charged against unrelated budget lines;
- A lack of dual control over the single lock safes with both sets of keys being kept by the respective cashiers;
- Inadequate physical security measures resulted from the Core Team's Finance Clerk sharing the Cashier's office. Furthermore, there was unrestricted access to the office and no payment window or alarm systems at both offices;
- A lack of adequate segregation of duties regarding the payment functions at both offices such as preparation and authorization of vouchers and payments by the same person;
- Relevant authorization from the Controller to carry out cashier functions had not been obtained; and
- A general lack of understanding of the requirements for cash management and no policy guidelines provided to staff on cash management and cashbook maintenance.

43. In our view, it is vital that immediate action be taken to correct these deficiencies in order to safeguard the large amount of cash handled by the Core Team and field offices.

Recommendation nos. 20, 21, 22 and 23

Habitat Northern Iraq should:

(i) Establish a proper supervisory system to monitor finance and cashiering functions in order to establish adequate internal controls including segregation of duties (AF01/32/2/020);

(ii) Immediately refrain from holding personal cash in safekeeping for staff. If this facility is to be provided, a policy should be established and a separate safe provided. Furthermore, such transactions should not form part of entries to the cash book (AF01/32/2/021);

(iii) Ensure that adequate security systems are installed in the new Core Team cashier's office and field offices which should include an alarm or video camera system (AF01/32/2/022); and

(iv) Revise the computerized cashbook system so that transactions entered in the system cannot be modified or deleted (AF01/32/2/023).

44. *Habitat agreed with recommendations 20 to 23 and based on Habitat's comments we have closed these recommendations in the OIOS database.*

Delays in recruiting qualified and experienced staff

45. A general lack of effective and efficient management was observed which we attributed to inadequate staffing and the absence of policies and guidelines. In view of the magnitude of Habitat's programme in Northern Iraq in terms of size and value, there is heavy reliance on the Core Team and field offices to function in an efficient and effective manner in order to ensure the timely implementation of the programme and to prevent financial losses. While we were informed that a number of new international staff would commence employment shortly, progress on improving the staffing complement to a more appropriate level has been slow. There is still a need to increase the international staffing level of the field offices.

46. Additional support from both Nairobi and the Core Team to establish adequate supervision, financial and administrative procedures, and standard operating policies and procedures were needed. This was evident by the absence of cash, personnel and asset management procedures, and the lack of standard contractor procurement procedures in the field offices. In our opinion, this has had a material impact on both internal controls and project implementation.

Recommendation nos. 24 and 25

Habitat Northern Iraq in conjunction with Habitat Nairobi and UNON should:

(i) Prepare plans to determine current and future staffing requirements, and develop a roster of pre-qualified candidates to meet staffing needs (AF01/32/2/024); and

(ii) Develop standard operating procedures for key financial and administrative areas including procedures for Northern Iraq field offices and operating procedures including procurement, inventory management of construction materials, charging of liquidated damages, evaluation of contractors (AF01/32/2/025).

47. *Habitat management agreed with recommendation 24 and it has been closed in our database. With regard to recommendation 25, Habitat has agreed to implement standard operating procedures with assistance from UNON.* In order to close this recommendation we request that Habitat inform us when preparation of the standard operating procedures will be completed.

Improvements are needed in asset management

48. Management of assets, including recording and establishment of accountability, should be done in accordance with the UN Financial Regulations and Rules. Our audit found that there was an absence of a proper asset inventory system in Habitat Northern Iraq. In addition, the value of the assets was not readily available and an absence of overall policy and procedure governing asset management was evident.

49. It has been the practice of Habitat Northern Iraq to rent office equipment and vehicles for use by the officers. Rental arrangements for office equipment, including computers, were for prolonged periods with total costs far exceeding the cost of purchasing. A review of the expense report at 30 June 2001 showed that the total rental expenses for June was $97,000.

Recommendation nos. 26 and 27

OIOS recommends that Habitat Northern Iraq:

(i) Establish and maintain a proper asset inventory system in order to minimize or prevent loss of assets and for proper accountability (AF01/32/2/026); and

(ii) Review the practice of renting equipment by conducting an analysis to determine the most economical option and explore the

possibility of obtaining ownership of rented assets after a period of time (AF01/32/2/027).

50. *Habitat agreed with recommendations 26 and 27 and indicated that they have been implemented.* We have therefore closed these recommendations in our database.

V. ACKNOWLEDGEMENT

51. We wish to express our appreciation for the assistance and cooperation extended to the auditors by Habitat in Iraq and Nairobi.

for Esther Stern
Director
Internal Audit Division, OIOS