UNITED NATIONS NATIONS UNIES

INTERNAL AUDIT DIVISION
OFFICE OF INTERNAL OVERSIGHT SERVICES

Reference: AUD-7-7:7 (0971/04) 16 December 2004

To: Mr. Rolf G. Knutsson, Executive Secretary
United Nations Compensation Commission,

From: for Patricia Azarias, Director
Internal Audit Division I, OIOS

Subject: **OIOS Audit Number AF2003/820/02 – Audit of UNCC E1 Claims: 10th installment**

1. I am pleased to present the final report on the subject audit, which was conducted in Geneva from October 2003 to December 2003. The audit was conducted in accordance with the standards for the professional practice of internal auditing in United Nations organizations.

2. The report incorporates as appropriate the UNCC Secretariat's comments on five of OIOS' preliminary audit queries/comments issued between 06 November and 01 December 2003. Concerning all recommendations excepting recommendations 4 and 8 of this report, we note from your comments to preliminary queries/comments that UNCC Secretariat considers these to fall outside of OIOS' proper scope of audit as per UNCC's interpretation of the opinion of Office of Legal Affairs. OIOS does not agree with this assertion, and we request that you review the additional explanations contained in this report and provide us with your comments. Please note that OIOS considers all of the recommendations in this report as being of critical importance.

3. I take this opportunity to thank UNCC management and staff for the assistance provided to the auditor in connection with this assignment.

Copy to:
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Office of Internal Oversight Services

Internal Audit Division I

Audit of UNCC E1 Claims: 10th Installment

Audit No.:	AF2003/820/02
Report date:	16 December 2004
Audit team:	Jayanti Prasad, Auditor in-charge

AUDIT OF UNCC E1 CLAIMS: 10TH INSTALLMENT

EXECUTIVE SUMMARY

OIOS conducted an audit of the tenth installment of "E1" claims consisting of eight claims submitted to the Panel, which recommended awards totalling $76,978,482 for claims with an asserted value of $203,699,176. All of the claimants are state owned or private Kuwaiti Companies in the oil sector. The Governing Council (GC) approved the recommendations made by the panel of Commissioners in its December 2003 session.

OIOS' findings were communicated in writing to UNCC as preliminary audit comments/queries before the GC approved the Panel's recommendations. UNCC's comments are incorporated in this report as appropriate.

UNCC follows the practice of awarding claims in US dollars for claims which are expressed, assessed and recommended in currencies other than US dollars, by using the exchange rate on the date of loss, instead of the date of payment. In OIOS' view, this exposes UNCC to the risk of substantial overpayments/underpayments and is not fair to all claimants as it puts claimants expressing their claims in US dollar at a clear disadvantage. Furthermore, the present system is also not in line with the UN Financial Regulations and Rules and decision number 18 of the Governing Council.

In OIOS' opinion, the present system has resulted in overpayments of $2,170,951 to the claimants in E1, 10th installment. Furthermore, in the absence of relevant information (which UNCC refused to provide), OIOS estimates that UNCC has overpaid by $.51 billion to date for other claims. In addition, it is estimated that UNCC would overpay future claims by $1.27 billion, under the current exchange rate procedures.

OIOS also concluded that there were inadequate internal controls and procedures to mitigate risks, which has resulted in overcompensation, inconsistent practices and inadequate procedures. For example, there was inconsistent application of methodology to evaluate claims relating to losses or damage of tangible goods. In other cases, there were inconsistent policies for the claimants to declare salvage value of damaged goods and to provide for complete information. Failure to adequately plan UNCC's work procedures in cases where the extra-ordinary income exceeded the asserted claim has resulted in wasted resources. In other instances, UNCC had not developed a policy to require the claimants to declare, ab-initio, that the claim elements (like salary payments to employees) they are claiming have not been, to the best of their knowledge, claimed separately by other claimants (like employees).

In response to OIOS' preliminary audit queries, the Secretariat stated that all queries, excepting the ones related to recommendation number 4 and 8, went beyond the scope of the OIOS audit as defined by the Office of Legal Affairs (OLA) opinion. Certain additional information, requested by OIOS, was also not provided citing the above reason. OIOS does not agree with the restrictions imposed on the scope of audit by the extremely narrow interpretation of the OLA opinion and other reasons amplified in Paragraph 7 and 8 of this report.

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LIST OF ABBREVIATIONS USED IN THE REPORT

Board of Auditors	BOA
Kuwaiti Dinar	KWD
Pound Sterling	GBP
Office of Internal Oversight Services	OIOS
Office of Legal Affairs	OLA
United Nations Compensation Commission	UNCC
Verification and Valuation Support Branch	VVSB

I. INTRODUCTION

1. OIOS conducted an audit of the Report and Recommendations made by the Panel of Commissioners concerning the tenth installment of "E1" claims. This claim consists of eight claims submitted to the Panel.

2. The Panel has issued its reports and recommendations with respect to seven of these eight claims. It did not make any recommendation in respect of a claim submitted by the Government of Kuwait on behalf of the Kuwait Petroleum Corporation because it exclusively concerns claim preparation costs. All of the claimants are state owned or private Kuwaiti Companies. The Governing Council reviewed "E1", 10th instalment claim in its December 2003 session and approved the recommendations made by the panel of Commissioners and awarded $76,978,482 to six claimants. The claims included in the report and recommendations of the Panel are shown in Figure 1:

Figure 1 : Tenth installment of "E1" claims

Claimant	UNCC Claim Number	Original amount claimed ($)	Amended Amount Claimed ($)
Kuwait Foreign Petroleum Exploration Company	4003086	14,899,000	14,442,161
Kuwait Oil Tanker Company	4003068	34,116,280	34,084,754
Kuwait Aviation Fuelling Company	4003067	26,119,536	25,908,633
Kuwait Santa Fe for Engineering & petroleum Projects Company	4004159	90,107	90,608
Kuwait Drilling Company	4003178	108,486,246	107,690,958
Kuwait Oilfield Supply Company	4003091	1,547,903	1,547,903
Independent Petroleum Group	4004900	19,934,159	19,934,159
Total		**205,193,231**	**203,699,176**

3. OIOS submitted memorandum containing preliminary findings to the UNCC Secretariat (Secretariat) between 06 November and 01 December 2003, prior to the Governing Council's review of the Panel's report on 18 December 2003. The Secretariat's responses to these were received between 14 November and 04 December 2003 and have been incorporated as appropriate in the audit report.

II. AUDIT OBJECTIVES

4. The objectives of the audit were to:

(i) Determine compliance and adherence with resolutions of the Security Council and the decisions of the Governing Council for processing "E" claims;
(ii) Evaluate the adequacy of internal controls over the processing of "E" claims;
(iii) Determine if the evaluation methodologies and evidentiary standards have been consistently applied in processing the claims;
(iv) Assess the appropriateness of the currency exchange rate used by UNCC to calculate dollar equivalent of losses incurred/claimed and assessed in other currencies; and
(v) Determine consistency of procedures and decisions in dealing with similar claims.

III. AUDIT SCOPE AND METHODOLOGY

5. We test checked the seven claims included in the Panel's report for the compensability of the claims, the procedures and methodology applied for valuation and verification of the asserted losses by the Secretariat, the supporting evidence submitted by the claimants, and the Panel's recommendations on the compensation to be awarded.

6. Except for comments relating to recommendation numbers 4 and 8, the Secretariat responded with regard to all of OIOS' preliminary findings that the comments went beyond the scope of audit as defined in the Office of the Legal Affairs opinion dated 27 November 2002 (the "OLA opinion"), as it considered the comments related to issues like (i) compensabilty, (ii) contract interpretation, (iii) weight and sufficiency of evidence, (iv) organisation of Panel's work, (v) mandate of UNCC and rules of international law, (vi) relevance of certain facts, (vii) mitigation of losses, (viii) valuation of compensable losses, (ix) determination of applicable law to define the nature and extent of losses etc., which were legal issues to be determined by the Panel of Commissioners and subject only to review by Governing Council . The Secretariat, however provided additional clarification on most of the queries and comments, but stated that "that should not be taken in anyway to derogate from the OLA opinion or to waive any of the conditions agreed upon in the MOU". On the basis of these assertions, the UNCC Secretariat refused to provide additional information on OIOS' query dated 01 December 2003.

7. OIOS does not agree with the restrictions placed on its audit scope and the extremely narrow interpretation of the OLA opinion. Claims awarded constitute UNCC expenses hence the audit of claims processing is fully within OIOS' scope. OIOS' mandate[1] is to"...review and appraise the use of the financial resources of the United Nations in order to guarantee the implementation of programmes and legislative mandates..." Furthermore, under Security Council Resolution 706(1991), funds from sales of Iraqi petroleum and petroleum products have to be deposited "into an

[1] General Assembly Resolution 48/218 B (1994)

escrow account to be established by the United Nations and administered by the Secretary-General..." The use of these funds is a United Nations responsibility within OIOS' audit scope.

8. Furthermore, the Board of Auditors (BOA) stated that the audit of claims is fully within the OIOS mandate because (i) the UNCC Governing Council is not of a "quasi judicial nature"; and (ii) the UNCC is managed by the United Nations Secretariat. Additionally, the Report of the Secretary General S2259 dated 2 May 1991 states "The Commission is not a court or an arbitral tribunal before which the parties appear; it is a political organ that performs an essentially fact-finding function of examining claims, verifying their validity, evaluating losses, assessing payments and resolving disputed claims. It is only in this last respect that a quasi-judicial function may be involved."

IV. OVERALL ASSESSMENT

9. The remedial action proposed by OIOS for deficiencies identified in the valuation and verification of claims could lead to potential savings of $1.78 billion. A summary of the financial implications of OIOS' findings appears in Figure 2.

Figure 2: Summary of Financial Implication of Audit Findings

UNCC Claim No.	Nature of Loss/Element of the claim	OIOS Recommended Adjustment (Original Currency)	OIOS Recommended adjustment (US $)
4003086	Income tax paid on behalf of certain employees	- GBP 69,343	-123,167
4003086	Increase in drilling rig costs for SLK-2	Equal to the de-mobilisation fee which was payable under the earlier Challenger contract	Not estimated Information N.A.
4003086	Additional drilling costs	-$860,337	-860,337
4003068	Towage charges	-KWD 90,830	-314,291
4003068	Loss of mobile crane	-KWD 4,000	-13,841
4003068	Loss of manufacturing facilities (Gas Branch)	-KWD 37,729	-130,550
4003068	Stolen commercial vehicles	-KWD 4,375	-15,138
4003067	Losses of other tangible property, vehicles	-KWD 8,755	-30,294
All claims in E1, 10th installment	Currency exchange rate used as on date of loss instead of date of determination/payment	-USD 2,170,951	-2,170,951
Awards effected to date	Currency exchange rate used as on date of loss instead of date of payment (likely Overpayment)	-$510,000,000	-$510,000,000
Future payments based on estimated claim awards	Currency exchange rate used as on date of loss instead of date of payment (Potential savings on estimated future payments)	- $1,270,000,000	- $1,270,000,000
Total			*-$1,783,658,569*

Note: For conversion purposes UN Operational exchange rate as of December 2003 have been used which were 0.563 for GBP and 0.289 for KWD

V. AUDIT FINDINGS AND RECOMMENDATIONS

A. Payment of claims expressed, incurred, assessed and recommended in currencies other than dollar

Current procedures can result in unintended gains or losses to claimants

10. The majority of the claimants submitted their claims in currencies other than US dollars. The Panel calculates and recommends awards in the original currencies claimed. However, because awards are made in US dollars, it is necessary to determine the US dollar exchange rate, which should apply. In this regard, the Panel relied upon the United Nations Monthly bulletin of Statistics, and awards then made at the exchange rate prevailing on the date of loss, which occurred between 2 August 1990 and 15 April 1992.

11. Furthermore, the date of loss was not precise in many cases. For example, where the claim was for loss of profits or payment of relief to others, and was incurred over a period of time, the Panel selected the mid-point of the compensable period. Similarly, for claim for loss of tangible assets, the Panel selected 2 August 1990 (the date of Iraq's invasion of Kuwait).

12. The UN normally pays (when required to pay in currencies other than US Dollars) at the UN Operational exchange rate on the date of payment. By determining the exchange rate to be applied as that of date of loss, UNCC has exposed itself to overpaying or underpaying the claimants for the losses determined to be compensable by the Commission. For example, if a claimant has been awarded INR100,000 for a loss suffered on 2 August 1990, UNCC would pay approximately $3000 (assuming for the purpose of calculation an exchange rate of $1= 33 INR in August 1990) at the rate prevailing on the date of loss. If, however, UNCC used the date of payment as the basis, this award would be approximately $2,222, at the exchange rate of $1 to INR45, when payment was authorised/made (Year 2003). Therefore, by using the exchange rate of August 1990, UNCC would have over-paid by $778 or INR 35,000. In general, it is a reasonable assumption that claimants should be paid the actual amount of loss and not be subject to the vagaries of exchange rate movements.

13. OIOS estimated that for the "E-1" 10th installment claims the overpayment on account of exchange rate was approximately $2,170,951 (i.e. the Panel should have recommended a total payment of $74,807,531 instead of $76,978,482). Annex shows the details of overpayment. Therefore, in OIOS opinion, UNCC should reduce the amounts of compensation to the claimants by $2,170,951.

14. Furthermore, in the event of an unfavourable swing in the exchange rate, the current system of using dates different from payment dates could lead to under-compensation to the claimant. In addition, using the exchange rate on the date of loss is not fair to claimants who claimed losses in US Dollars since they are awarded the exact amount of loss as determined by the Commission.

Present procedures are in contradiction of Governing Council decisions

15. The Governing Council's Decision 18 of 1994 on "Distribution of Payments and transparency" requires that " If Governments convert US dollar payments received from the UNCC into other currencies for distribution of awards to the claimants, they shall notify the Governing Council on the method of conversion and exchange rate used, bearing in mind the interests of claimants in receiving full equivalent of their awards". In OIOS' opinion the current system of exchange rate on the date of loss being used by UNCC is in contradiction with the Governing Council decision, as it can be reasonably expected that the Governments would use the exchange rate as on the date of payments received from the UNCC to convert rather than the rate that was prevailing on the date of loss.

Impact of current procedures on claims

16. If the recommended approach is adopted by UNCC, it would impact not only claims to be resolved by UNCC but would also effect claims awarded and not paid fully. For instance, as of 10th November 2003, there was approximately $28 billion outstanding payment for claims awarded (out of approximately $46 billion awarded) and approximately $95 billion asserted claims not yet resolved. Assuming the average success rate of claims resolved to be approximately 18 per cent of the claimed amount to continue, this means that UNCC is likely to make further awards of approximately $17 billion. Thus, the target payments that would be impacted by the OIOS' recommendation are to the order of $45 billion.

17. Since UNCC refused to provide further information requested by OIOS, taking the percentage overpayment for "E1" 10th installment claims as the basis (2.82 percent of the award), OIOS estimates overpayment on claims already paid to be approximately $.51 billion and potential overpayment on future claims to be approximately $1.27 billion. Therefore, the total financial implication of OIOS' recommendation is estimated at $1.78 billion.

UNCC response

18. In response to OIOS' preliminary comments in this regard, UNCC Secretariat's stated that:

i. "The guiding legal principle is that the role of the decision-maker is to put the claimant back into the position that it would have been in if the wrongdoer had not committed its unlawful acts. This means that the focus of the inquiry is on the factual and legal situation at the time that the alleged losses were sustained by the claimant".

ii. "Another important consideration is that panels of Commissioners have been reviewing claims in which the issue of currency exchange rates arises for more than nine years of UNCC claims processing. All of the panels of Commissioners have adopted a common approach, the merit of which OIOS appears to wish to contest. This raises serious concerns about the nature of comments and queries identified by OIOS at a time when almost all of the claims filed with the UNCC have already been processed. In particular, the secretariat

considers that, if OIOS had wished to comment on the currency exchange rates used by the panels of Commissioners, it could have done so at an earlier date. The secretariat also note that, if the proposals put forward by OIOS were implemented, claims in the final instalments processed by the UNCC would be treated differently than more than 1 million previously awarded claims".

iii. "In the E1/10 Report, the "E1" Panel applied the currency exchange rate at the date of loss, which is consistent with the approach taken in all of its previous reports as well as all of the previous reports of other panels of Commissioners addressing the issue".

iv. "Furthermore, under the currently applicable payment mechanisms, the awards of compensation for claims in the E1/10 report are subject to the interim payment mechanism set out in Governing Council decision 197 (S/AC.26/Dec.197(2003)), which provisionally substituted the payment mechanism set out in Governing Council decision 100, as amended (S/AC.26/Dec. 100(2002)/Rev. 1). Under either of these payment mechanisms, the awards of compensation for the claims in the E1/10 report will be subject to one or more interim payments at dates that cannot be fixed with any certainty, as they will depend on the flow of proceeds from Iraqi oil sales into the Compensation Fund".

v. "The OIOS auditor also suggests that to modify the currency exchange rates to the "date of determination" (which he defines in paragraph 11(i) as "the date of Panel's approval or GC approval or payment") would bring UNCC practice in line with the Financial Rules and Regulations of the United Nations. In response to this contention, as a preliminary matter the secretariat refers to the remarks in the previous response and observes that the OIOS auditor has not himself defined the "date of determination", which appears to be one of three possible dates. The secretariat notes that the valuation of war reparations is not a matter within the purview of the Financial Rules and Regulation of the United Nations, which quite properly concerns the payment of ongoing operating expenses and other obligations incurred by the United Nations. These rules are of course applicable to the operating expenses and other obligations of the UNCC. The payment of compensation for claims, however, is an obligation of Iraq under Security Council resolution 687(1991), and in no way constitutes an obligation of the United Nations. This issue was the subject of a separate opinion issued by the Office of the Legal Advisor in response to a query raised by the United Nations Board of Auditors in 2001, which was provided to OIOS".

vi. "The OIOS auditor further suggests that it would be more fair to claimants, those asserting claims in United States dollars as well as those advancing their claims in other currencies, to apply his proposed "date of determination". In response to this contention, and assuming that such a date can in fact be determined (see earlier comments), it is difficult for the secretariat to agree with the auditor's reasoning on this point. The value of an item that is lost or destroyed is its value when the owner was deprived of it. The OIOS auditor, in previous preliminary comments arising out of his review of claims in the E1/10 report, appears to concur with this principle when he expresses a preference for valuing tangible property using the net book value of the claimed asset at the date of loss".

vii. "The secretariat considers that the value of the lost asset is "fixed" at that date of loss, regardless of the currency in which it was labelled at that time. There can therefore be no unfairness between claimants who advanced claims in different currencies because, at that date, the exchange rate is fixed. Subsequent fluctuations in exchange rates are not due to the act of the wrongful party - in this case, Iraq – or to the acts of the claimant. Neither Iraq nor the claimants should receive a windfall or suffer a penalty due to such fluctuations. On the other hand, the secretariat considers that the application of the currency exchange rates proposed by the OIOS auditor are potentially discriminatory because in 2003 there are differences in the currency exchange rates applicable to the compensable losses. These differences are underscored by what the OIOS auditor terms the "overpayment" in paragraph 7 of the preliminary audit comments".

19. The UNCC Secretariat's response is not clear as various Panels have themselves recognised that Courts or Tribunals generally use one of the three dates in determining the proper rate of exchange: (i) Date of loss; (ii) date of judgement; and (iii) date of execution of the judgement (date of payment). This is evident from the various Panel Reports (e.g. S/AC26/1997/6). Therefore, the date of payment is equally acceptable from a legal point of view. Furthermore, the key issue here is that the claimants should be compensated for their losses in exact amounts that they lost and not more or less. Therefore, the exchange rate is not relevant, if awards are made in the currencies claimed. However, if the date of payment is used for exchange rate purpose under the present system, that would ensure that the claimants get the exact amounts of their losses and not more or less. Additionally, the fact that the present system is in practice for the last nine years and OIOS could have commented it upon earlier is no reason not to establish a better, fairer and more economical method in line also with UN Financial Regulations and Rules and in consistency with the Governing Council's decision 18.

Recommendations 1, 2 and 3

UNCC Secretariat should:

(i) Reduce the awards made for "E1" 10th installment claims by $2,170,951 (AF03/820/02/01);

(ii) Amend the system used to determine the currency exchange rate for awards in currencies other than US dollars as the rate prevailing on the date of payment, in order to:

- mitigate the risk of overpayment or underpayment;
- bring the exchange rate procedures in line with UN Financial Regulations and Rules;
- ensure fairness to both type of claimants, those submitting their claims in US dollars and those who submitted their claims in currencies other than US dollars;

- ensure consistency with the Governing Council decision 18 requiring claimants to receive full equivalents of their awards (AF03/820/02/02); and

(iii) Apply the currency exchange rate for awards in currencies other than US dollars at the rate prevailing on the date of payment, to claims already awarded but not paid in full and to future claims (AF03/820/02/03).

B. Claim 4003086 – Kuwait Foreign Petroleum Exploration Company (KUFPEC)

20. KUFPEC originally sought compensation in the amount of $14,899,000 for additional costs, delayed income and damage to physical assets as a result of Iraq's invasion and occupation of Kuwait. In October 2002, KUFPEC reduced the amount claimed to $14,442,161.

Procedures to avoid duplicate payments should be strengthened

21. UNCC informed us that they have established procedures to ensure that there are no other claims for the same loss. In this regard, we enquired whether UNCC require the claimants (companies etc.) to declare in their claims that the elements they are claiming have not been separately claimed by others.

22. The UNCC Secretariat responded that " In the case of KUFPEC, the secretariat asked this question further to a notification issued pursuant to Article 34 of the Rules. KUFPEC responded that, to the best of its knowledge, no duplicative claims had been filed for the losses that it asserted in its claim. In many cases, the claimants will have no information on this issue, as the relationship between the claimants will not have been re-established following Iraq's invasion and occupation of Kuwait. For example, KUFPEC could not be expected to have knowledge or information concerning the potential claims of its former employees. In such cases, the secretariat systematically conducts cross category checks to identify potentially duplicative claims."

23. Thus, it is evident that UNCC does not require the claimants to declare ab-initio that the claim elements, to the best of their knowledge, have not been claimed separately by others. This leaves the detection of possible duplicate payments solely to UNCC increasing their workload and risk.

Recommendation 4

UNCC should obtain a declaration from all claimants of unresolved claims, requiring them to state, to the best of their knowledge that their claim elements have not been separately claimed by others (AF03/820/02/04).

Lack of provisions for penalties on submission of grossly inflated or unsubstantiated claims

24. We also enquired if there are policies, to penalize claimants if claims submitted are found to be grossly inflated or unsubstantiated, or are found to be inadmissible because of incorrect facts having been submitted. Gross inflation or unsubstantion of claims is indicated by the fact that until 19 March 2004, out of approximately $266 billion asserted, only approximately $48 billion was awarded by UNCC. The average success rate of claims resolved stands at approximately 18 per cent in terms of amount. In terms of numbers, out of approximately 2.6 million claims that have been resolved, only approximately 1.5 million have been awarded i.e. approximately 42 per cent claims have been rejected in their entirety.

25. In response to OIOS' enquiries, the Secretariat stated that other then rejecting the claim in its entirety, neither the Security Council Resolutions or the Rules adopted by the Governing Council provide for any sanction to be imposed by the UNCC on claimants whose claims are not substantiated or grossly inflated. OIOS is of the opinion that since all claims are received through the Governments/International Organizations and are thus expected to have been vetted to some degree, there should be a provision in the Rules which would allow UNCC to take some action against the claimants who file grossly inflated, fraudulent or unsubstantiated claims.

Recommendation 5

UNCC should request the Governing Council to establish provisions in the Rules to provide penalties against claimants who file inflated, unsubstantiated or fraudulent claims (AF03/820/02/05).

Income tax paid on behalf of certain employees

26. Income tax paid by KUFPEC on behalf of its employees to the UK and Northern Ireland Authorities of GBP 69,343 was considered compensable as a part of $1,282,154 recommended on account of claim for Miscellaneous Head Office expenses. In OIOS' opinion once salary paid in the UK to staff was held to be compensable and an award made, to compensate the Company for income tax paid on behalf of the staff to Authorities leads to overcompensation. Income tax is a personal liability and not that of the Company. The fact that the individuals could have claimed the income tax in their individual claims is not relevant in order to decide the claim of an employer Company. Furthermore, the claimant clearly did not mitigate its losses for which compensation was claimed by asking the individual employees to pay the income tax.

27. In response to OIOS' preliminary comments, the UNCC Secretariat stated that the "E1" Panel considered that KUFPEC's payment of income tax on behalf of its relocated employees was an incremental cost that was incurred as a direct result of Iraq's invasion and occupation of Kuwait.

Recommendations 6 and 7

UNCC should:

(i) Seek a legal opinion on the question whether income tax paid by an employer company (which has been compensated for salaries paid to its staff) on behalf of its staff is compensable to the employer company despite the fact that income tax is a personal liability of the staff and not that of the company (AF03/820/02/06); and

(ii) Reduce the award to the claimant by GBP 69,343 on account of income tax paid by the claimant on behalf of its staff, which is clearly the personal liability of the staff (AF03/820/02/07).

Discrepancy in amounts included in the Panel's report

28. We noted that KUFPEC's also claimed relocation costs of $1,305,730 relating to three different countries, which was incurred in different currencies. Paragraph 51 of the Panel's report states that "based on documentary evidence that was presented, the Panel has verified payments by KUFPEC in the amounts of $27,649; 1,736,044 AED; 248,093 GBP and 217,656 Kuwaiti Dinars for a total of $1,282,154. The Panel recommends an award of compensation in that amount."

29. We verified that the Verification and Valuation Support Branch (VVSB) of UNCC certifies that all figures included in the draft panel report are correct and have been verified, before the Panel finally signs on its Report. However, the coordination between the VVSB's certification and the Panel's final approval of the Report was weak. Despite VVSB certifying the correct figure of KWD 89,752 instead of KWD 217,656 included in the Panel final report, the Panel report used the incorrect figure of KWD 271,656.

30. In response to OIOS comments in this regard, UNCC agreed with OIOS and stated that the correct figure in paragraph 51 of the report, should be KWD 89,572 instead of KWD 217,656. The Secretariat further stated that it thanks OIOS for spotting this clerical error, and recognizes the contribution that the OIOS review can make to the UNCC process in identifying such errors.

Recommendation 8

The UNCC Secretariat consider strengthening the internal controls and coordination between various branches of UNCC to avoid such errors occurring in future. (AF03/820/02/08).

Demobilisation fees

31. The Panel recommended an award to KUFPEC of $195,000 as demobilisation fee paid to Intairdrill Limited ("Intairdrill"). It stated that this was an extra expense that it would not have

incurred under the previous drilling contract with Challenger International Services Limited ("Challenger"), which was discontinued due to Iraq's invasion of Kuwait. However, the Challenger contract also contained a provision for payment of demobilisation fee, which was waived by Challenger. KUFPEC further contended that it would not have been required to pay the demobilization fee to Challenger, had the contract not been terminated earlier, as it intended to exercise the option to extend the contract to drill additional wells.

32. Furthermore, as Challenger had waived the demobilisation fee due to early termination as a result of Iraq's invasion and occupation of Kuwait, this reduction in expenses to KUFPEC was also attributed to that cause, and should have been treated as an "extra-ordinary" income, in OIOS' opinion. Thus, while $195,000 was clearly an additional expense, which was compensable, this should have been adjusted against the mobilisation fee which was payable by KUFPEC to Challenger. The UNCC Secretariat did not provide the figures for the demobilization fee payable by KUFPEC under the Challenger Contract.

33. In response to OIOS' preliminary comments in this regard, UNCC stated that the "E1" Panel considered that, under the contract, KUFPEC would not have to pay the demobilization fee if Challenger found work for the rig in the immediate vicinity of its location at the time when it had completed the drilling of the KUFPEC wells. The "E1" Panel considered that, pursuant to the contract, if KUFPEC had exercised its option to drill extra wells, and the rig had stayed in the area of the same field in Tunisia to drill those additional wells, then KUFPEC would not have been contractually liable to pay a demobilization fee. The "E1" Panel considered that KUFPEC had presented sufficient evidence to show that it would have exercised the option under those circumstances.

34. The response of UNCC contradicts the Challenger Contract, which provided for a demobilisation fee. In OIOS' opinion even if the Challenger contract had been extended in the "no-invasion" scenario, KUFPEC would have had to pay the demobilization fee to Challenger at the end of the contract.

35. No response was given to the comments of OIOS that the waiver of demobilization fee by Challenger could have been taken as "extra-ordinary" income. Furthermore, the fact that there was no net claim awarded after adjustments, should not be a reason for not accepting the principles that the Panel's Report should have been amended through a corrigendum to that extent for GC's review. Furthermore, this claim element was in fact part of the $860,337 recommended for award by the Panel.

Recommendation 9

UNCC should reduce the award made to KUFPEC for de-mobilization fee by an amount equivalent to the de-mobilization fee which was payable under the Challenger contract (AF03/820/02/09).

Claimant did not provide the requested information

36. KUFPEC Tunisia incurred $1,911,860 in additional drilling costs and extra mobilisation and de-mobilisation fees. However, later on KUFPEC Tunisia received partial reimbursement from a public oil sector company "Entreprise Tunisienne por les Activites Petrolieres" (ETAP) for KUFPEC's claimed extra drilling expenses of $1,912,000 and accordingly, the Panel recognized that KUFPEC's award should be reduced by the amount of reimbursement received from ETAP.

37. Despite requested to do so by UNCC, KUFPEC did not provide a breakdown of ETAP payment, in the absence of which the Panel deducted 55 per cent from the compensable amount of $1,911,860 and recommended an award of $860,337 (55 per cent being the maximum which in Panel's view would have been owed to KUFPEC Tunisia by ETAP as a result of undivided joint interest in the mining concessions). In OIOS' opinion the failure of KUFPEC to provide a breakdown of reimbursement received from other sources for claimed elements is unacceptable. Therefore, there was no appropriate basis for making an award for this claim element.

Recommendation 10

UNCC should not recommend any amount for claim relating to additional drilling costs and extra mobilisation and de-mobilisation fees of KUFPEC due to it's failure to provide the information requested by UNCC (AF03/820/02/10).

38. In response to OIOS' preliminary comments in this regard, the UNCC Secretariat stated that "the Panel considered that the contract provided by KUFPEC indicated that it was ultimately responsible for 45% of the additional costs and fees, as the joint venture partner was required to reimburse 55% of such costs. Based on evidence submitted by KUFPEC, the Panel found that the claimant had actually paid the entire amount of the additional costs and fees at issue. The Panel also reviewed evidence provided by the claimant indicating that some of these amounts had been reimbursed by ETAP according to the contractually defined percentage. Absent any additional evidence provided by the claimant concerning which of the amounts had been reimbursed, and the basis upon which other items had not been reimbursed, the Panel adopted the inference that was most disadvantageous to the claimant – that being that the full 55% of costs, which should have been reimbursed by its joint venture partner under the contract, were not compensable as such costs did not constitute a loss to the claimant sustained as a direct result of Iraq's invasion and occupation of Kuwait".

39. OIOS also enquired whether UNCC made an attempt to get the details of reimbursement from ETAP directly. UNCC responded by stating that Article 36 of the Rules does permit the Panel to solicit information from claimants or "any other source" at its discretion. The Panel exercised its discretion in this case not to solicit additional information, as it had sufficient information upon which to reach a recommendation on the amount of compensable loss.

40. In OIOS' view, the failure to obtain relevant information from KUFPEC and also from ETAP, regarding the amount reimbursed by ETAP to KUFPEC, exposed UNCC to relying on less reliable and incomplete data.

Extraordinary income from production of oil

41. The Panel's report stated that they had earlier found that crude oil prices increased following 2 August 1990 as a direct result of Iraq's invasion and occupation of Kuwait. The panel had also consistently held that any extraordinary profit that a claimant enjoyed as a result of these price increases must be off set against the claimant's compensable losses.

42. The Panel found that KUFPEC's extraordinary income from oil sales far exceeded the level of compensable losses recommended ($2,738,428) and accordingly recommended no net award to the claimant. VVSB's assessed the extraordinary income to be approximately $25 million, which was more than the $14.89 million originally claimed.

43. In OIOS' opinion, in claims of this nature, the extraordinary income should be assessed by UNCC before considering the various elements of the claims. If the assessed extraordinary income is more than the original claimed amount, there is no need for UNCC to determine the compensability of all elements of claims and then their valuation, verification etc. The present practice where UNCC determines and recommends awards for each element and then determines the extraordinary income, is inefficient and leads to waste of resources.

44. In response to OIOS' preliminary comments, the UNCC Secretariat stated "the "E1" Panel has reviewed a number of claims in which it has considered the effect of extraordinary profits. In all cases, the "E1" Panel considered that the Governing Council would want to review the basis of its calculations on both of these elements before approving the award of compensation recommended by the Panel to take into account extraordinary profits".

45. In OIOS' view if the GC is briefed about the resultant savings of resources obtainable as a result of OIOS' recommendation which would also be fair to the claimants, they may not want to review the valuations, calculations and awards made on each element of claims, in cases where the extraordinary income is assessed to be more than the total asserted claim of a claimant.

Recommendation 11

UNCC should first assess extra-ordinary income, before considering the various claim elements and their compensability, in order to determine if the assessed extraordinary income is more than the claimed amount. (AF03/820/02/11).

46. OIOS also enquired whether the claimants are asked by UNCC to assess and declare any extraordinary income. OIOS believed that if the claimants were indeed asked to declare any extra-ordinary income that would assist UNCC to establish the compensable amount in a more efficient and effective manner.

47. The UNCC Secretariat responded to the query by stating that the mandate of the UNCC is to determine the liability of Iraq for losses caused as a direct result of its invasion and occupation of Iraq. No provision of Security Council Resolution 687 requires a claimant to reimburse Iraq for any extraordinary profits that it may have realized as a result of Iraq's wrongful act.

48. The response of UNCC is not relevant and is contrary to established practice of UNCC holding that any extra-ordinary profit that a claimant enjoyed as a result of crude oil price increases following Iraq's invasion of Kuwait must be off-set against the claimant's compensable losses.

Recommendation 12

UNCC should request the claimants to declare any invasion driven extraordinary income while submitting their claims or in response to subsequent questions when the claim is processed by UNCC. (AF03/820/02/12).

C. Claim No. 4003068: Kuwait Oil Tanker Company (KOTC)

49. KOTC claimed KWD 9,850,494 for damages and losses that were allegedly sustained by four of its business units as a direct result of Iraq's invasion and occupation of Kuwait. This included loss of profits of KWD 3,998,771 (business transaction or course of dealing) and damage or losses to tangible property of KWD 5,851,723.

Loss of crew boats

50. Only one of the three crew boats allegedly sank by Iraqi forces, named NAKILAT 75 (the other two being NAKILAT 72 and NAKILAT 73) was raised and repaired. The other two were declared total losses. KOTC claimed KWD 90,640 for each of the two vessels that were not repaired and the Panel report states that in case of NAKILAT 75, KOTC submitted documentation showing actual repairs cost of KWD 65,680.

51. OIOS enquired from the Secretariat whether the other two vessels (NAKILAT 72 and NAKILAT 73), which were declared total losses, were also raised. And if so, whether these were re-sold as scrap. In response, the UNCC Secretariat stated that the "E1" Panel accepted the evidence supplied by KOTC that, at the time of filing its claim, the two vessels had not been raised. However, the response does not clarify whether these two vessels were raised and sold as scrap subsequent to the filing of the claim.

Recommendation 13

UNCC Secretariat should determine whether the two vessels were raised subsequent to the filing of the claim and the salvage value. If any proceeds were received from their sale, the claim should be reduced by this amount (AF03/820/02/13).

Towing charges claim awarded despite being covered by insurance

52. KOTC did not claim for the cost of repairs of its vessel STRIKER because it received indemnity payments from its insurer for this loss element. However, KOTC claimed KWD 90,830 for the actual cost of towage of STRIKER to a foreign repair yard in Sharjah, since it alleged that its settlement with the insurer for damage to STRIKER did not include reimbursement for towage charges.

53. The Panel verified STRIKER's marine insurance policy included "war risk" coverage and found no evidence that towage expenses were excluded from insured's coverage under those policies. Footnote 33 of the Panel's reports states that the war risk policy for STRIKER does not specifically exclude towage cost and that KOTC was unable to produce documentation explaining why its insurance settlement did not include reimbursement for cost of towage of STRIKER to the repair yard in Sharjah, although it speculated that the cause might have been oversight in failing to file a claim with the insurer for this expense.

54. It is noteworthy that KOTC received full reimbursement for cost of repairs to STRIKER of KWD 311,397 from the insurer. Thus, in OIOS' opinion, had KOTC claimed towage charges of KWD 90,830 from the insurer, even that would have been reimbursed by the insurer, as the insurance policy did not exclude the towage charges. Clearly, KOTC failed to mitigate its loss before filing a claim with UNCC.

55. Furthermore, the Panel stated in its report that having reviewed other documents submitted by KOTC regarding the settlement of its casualty claim with its underwriter, it was satisfied that KOTC did not receive an indemnity payment with respect to towage charges. The Panel also noted that the Commission does not require a claimant to exhaust all other remedies before pursuing its claim. Thus, even though KOTC did not pursue a claim for towage against its insurer, this claim element was entertained. The Panel further noted that an indemnity payment for towage costs would likewise have been recoverable against Iraq, if pursued by the insurer. Accordingly, the Panel recommended an award in the full amount of KWD 90,830 for towage charges.

56. In OIOS' view, whether the insurer would have filed a claim with UNCC and whether that was compensable or not, had he paid indemnity payment for towage charges to KOTC, should not be a relevant factor to decide KOTC's claim. Furthermore, whether the amount was compensable, if pursued by insurer, is in doubt, as the insurance included war risk.

57. In response to OIOS' comments, the UNCC Secretariat stated that "the "E1" Panel considered that KOTC had suffered a loss as a direct consequence of Iraq's invasion and occupation of Kuwait, and that it had not received compensation for that loss from any other source. Furthermore, the Panel found that the claimant provided sufficient evidence to prove the amount of the loss. With respect to the compensability of insurance claims by insurers for amounts paid to indemnify otherwise compensable losses sustained by policyholders, the "E/F" Panel considered that such claims were compensable according to the provisions of Governing Council decision 7, which states that "compensation is available "to reimburse payments made or relief provided by corporations or other entities to others – for example, to employees, or to others pursuant to contractual obligations – for losses covered by any of the criteria adopted by the Council". The response of UNCC is not clear as it does not address the issue as to relevance of facts relating to the insurer while deciding the claim of the claimant, as pointed out in paragraph 56 above.

58. OIOS also enquired whether the insurer filed a claim with UNCC for the indemnity payment for repairs of KWD 311,397 which was reimbursed to KOTC and whether UNCC verified this. In OIOS' opinion if the insurer did not file a claim for this, the logic used by Panel while recommending award for towage charges, that insurer would have claimed for towage charges (if he had reimbursed to KOTC) does not appear to be logical.

59. In response to OIOS' comments, the UNCC Secretariat stated that the "E1" Panel did not conduct a cross check to determine whether the marine insurer filed a claim for repair costs to the STRIKER because KOTC did not claim for its repair cost for the STRIKER; thus, there was no risk of Iraq paying twice for the same loss. The "E1" Panel would not therefore have considered the absence of a claim by the insurer relevant to the compensability of KOTC's claim.

60. OIOS also enquired whether UNCC verified if the insurer had made indemnity payment for towage charges to KOTC. The UNCC Secretariat's response however, did not indicate whether they had contacted the insurer for the information. OIOS is of the opinion that KOTC failed to mitigate its losses through its insurer (to the extent of towage charges of KWD 90,830) as it could have obtained reimbursement of towage charges from the insurer if they had claimed it.

61. In response to OIOS' preliminary comments, Secretariat stated that the Panel considered that "the claimant's failure to request its insurer to reimburse these costs did not preclude it from recommending an award of compensation to KOTC. The "E1" Panel's approach to this issue is consistent with the approach of other panels to this issue".

Recommendation 14

UNCC should reduce the award to the claimant for towage charges from KWD 90,830 to 'nil' (AF03/820/02/14).

D. Inconsistent approach to valuing claims relating to loss of tangible assets

62. OIOS observed that the Panel did not follow consistent valuation methodology while processing claims relating to losses of tangible assets. Awards were often made for fully depreciated (net book value was nil) in varying amounts (often 5 per cent of the historical cost or some other value), whereas the Panel itself had on many occasions restricted the award for similar claims (at times for the same claimant) to the net book value. In OIOS' opinion in these cases the award should have been restricted to no more than "net book value". This has resulted in overcompensation totaling KWD 54,859 in these cases. The summary of these cases is shown in the Figure 3:

Figure 3: Summary of OIOS' comments relating to tangible assets with minimal net book value

Claim No. /Claimant	Item	Claimed Amount (KWD)	Net Book Value	Recommended award (KWD)	OIOS's comments/observations
4003068/KOTC	Mobile crane	25,750	0	4,000	13 years old as at 2 August 1990. Received free from an affiliate, Nil book value
4003068/KOTC	Gas bottling plant	618,000	500	38,229	Plant ceased operations in 1987, almost fully depreciated with net book value of only KWD 500
4003068/KOTC	Stolen commercial vehicles	391,400	0	4,375	Fully written off before invasion, nil book value
4003067/KAFCO	39 vehicles	179,000	16,490	25,245	34 vehicles fully written off prior to Iraq's invasion, 5 vehicles written off between September 1990 and February 1993. Net book value KWD 16,490. Vehicles age in 1990 ranged between 2 to 21 years, whereas useful life was only 2 to 5 years
Total		**1,214,150**	**16,990**	**71,849**	Restrict awards to net book value

63. Recommending an award for a claim for assets different from net book value appeared inconsistent with Panel's own approach in other cases, where it has recommended/restricted awards equivalent to 'net book value' of a lost/damaged asset. (Refer Para 150 (b), 156, 157 (d) of the Panel's Report). OIOS enquired if there was a consistent policy in UNCC to award claims based on "net book value" for loss to tangible assets and, if not, should UNCC not consider that?

64. In response, the Secretariat stated that the decision to apply a particular valuation approach is made by the panels of Commissioners based on the consideration of all of the circumstances in a particular case. Net book value is an important valuation tool for those panels reviewing the claims of business entities that in their regular course of business produced accounts and financial

statements. In certain circumstances, as in the case of KOTC's crane, the "E1" Panel used another basis of valuation. They further stated, "that similarly situated claimants should be similarly treated, and therefore the methodology applied by a panel to a particular group of claims will usually adopt a consistent approach". However, OIOS observes that there are no specific guidelines prepared in this regard to assist in valuation of losses to tangible assets.

Recommendations 15 and 16

(i) UNCC Secretariat should restrict the awards indicated in the Figure 3 to the total net book value of KWD 16,990 instead of KWD 71,849 (reduction of KWD 54,859) (AF03/820/02/15); and

(ii) UNCC Secretariat should formulate comprehensive guidelines for valuation of tangible assets losses, which should include all methods of valuations (like net book value or depreciated historical costs, insured value, market value, depreciated replacement costs etc.) and the circumstances where one method would be preferable to the other (AF03/820/02/16).

E. Conclusions

65. As discussed above, OIOS audit of selected "E-1" 10th instalment claims raised a series of questions concerning the awards made by the Secretariat, which in OIOS' view resulted in substantial overcompensation of the claimants and the findings have an impact on all awards done by UNCC. As the Secretariat's responses to preliminary comments have not fully addressed these concerns, OIOS believes that it is imperative for the UNCC to re-examine the issues discussed in this report, and adjust the amounts of compensation awarded in these claims and implement the proposed change in the existing policy of using the exchange rate as on the date of loss for awards in US dollars for claims incurred, expressed and assessed in currencies other that US dollars.

Recommendation 17

OIOS recommends that the UNCC Secretariat inform the Governing Council of the OIOS recommendations contained in this report for their consideration and appropriate action (AF02/27/3/17).

VI. ACKNOWLEDGEMENT

66. We wish to express our appreciation for the assistance and cooperation extended to the auditor by the Secretariat.

for Patricia Azarias, Director
Internal Audit Division I, OIOS

ANNEX

E1 - 10th INSTALLMENT CLAIMS

Claimant	Recommendation (KWD)	Date of loss	Exchange rate used by UNCC	Recommendation (in USD)	Exchange rate in July 2003	Amount which should have been recommended using July 2003 exchange rate	Overpayment (USD)
Kuwait Foreign Petroleum Exploration Co.							
1.Payment or relief to others	-	n/a	n/a	nil	n/a		
2.Other tangible property	-	n/a	n/a	nil	n/a		
3.Contract	-	n/a	n/a	nil	n/a		
4.Business transanction or course of dealing	-	n/a	n/a	nil	n/a		
Total				0		0	
Kuwait Oil tanker Company							
1. Business transanction or course of dealing							
1A. Fleet Operations	11,915						
1B. Agency Branch	1,731,513						
Sub-Total of 1	1,743,428	15-Jul-91	0.292	5,970,644	0.299	5,830,863	139,781
2. Other tangible property	2,939,087	02-Aug-90	0.289	10,169,851	0.299	9,829,722	340,129
Total	**4,682,515**			**16,140,495**		**15,660,585**	**479,910**
Kuwait Aviation Fuelling Company							
1. Business interruption	2,796,211	15-Aug-91	0.291	9,608,973	0.299	9,351,876	257,096
2. Other Tangible Property	226,917	02-Aug-90	0.289	785,180	0.299	758,920	26,260
Total	**3,023,128**			**10,394,152**		**10,110,796**	**283,356**
Kuwait Santa Fe							
1. Prepaid contracts	10,334	02-Aug-90	0.289	35,758	0.299	34,562	1,196
2. Other Tangible property	9,779	02-Aug-90	0.289	33,837	0.299	32,706	1,132
Total	**20,113**			**69,595**		**67,268**	**2,328**
Kuwait Drilling Company							
1. Real Property	9,441	02-Aug-90	0.289	32,668	0.299	31,575	1,093
2. Other tabgible property	10,438,405	02-Aug-90	0.289	36,119,048	0.299	34,911,054	1,207,995
3. Lost income	4,057,893	15-Apr-92	0.295	13,755,569	0.299	13,571,548	184,021
Total	**14,505,739**			**49,907,286**		**48,514,177**	**1,393,108**
Kuwait Oilfield Supply Company							
1. Business transanction or course of dealing	11,489	31-Oct-90	0.289	39,754	0.299	38,425	1,330
2.Other tangible property	5,265	02-Aug-90	0.289	18,218	0.299	17,609	609
3. Loss of income	21,159	31-Jan-91	0.289	73,215	0.299	70,766	2,449
Total	**37,913**			**131,187**		**126,799**	**4,388**
Independent Petroleum Group							
1. Payment or relief to others	98,044	01-Aug-91	0.292	335,767	0.299	327,906	7,861
Total	**98,044**			**335,767**		**327,906**	**7,861**
Grand Totals				**76,978,482**		**74,807,531**	**2,170,951**