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UNITED NATIONS

Oil for Food Program
Provides Lessons for Future
Sanctions and Ongoing
Reform

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Highlights of [GAO-06-711T](#), a testimony before the Subcommittee on National Security, Emerging Threats, and International Relations; Committee on Government Reform, House of Representatives

Why GAO Did This Study

In 1996, the United Nations (UN) and Iraq began the Oil for Food program after sanctions were imposed in 1990. The program was intended to allow the Iraqi government to sell oil to pay for humanitarian goods and prevent it from obtaining goods for military purposes. More than \$67 billion in oil revenue was obtained through the program, with \$31 billion in assistance delivered to Iraq.

Internal controls serve as the first line of defense in preventing fraud, waste, and abuse and in helping agencies achieve desired outcomes.

GAO assesses (1) the control environment the UN established for managing the sanctions and Oil for Food program and (2) other key internal control elements. In addition, we provide observations on the lessons learned from the program.

What GAO Recommends

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

www.gao.gov/cgi-bin/getrpt?GAO-06-711T.

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

UNITED NATIONS

Oil for Food Program Provides Lessons for Future Sanctions and Ongoing Reform

What GAO Found

The UN—the Security Council, the Secretariat, and member states—established a weak control environment for the Oil for Food program at the beginning. The UN allowed Iraq to control contract negotiations for imported commodities with little oversight, enabling the regime to obtain illicit funds through surcharges and kickbacks. The UN did not take steps to address the economic impact that the sanctions had on countries that depended on Iraqi trade, which undermined international support for sanctions and allowed Iraq to smuggle oil outside the Oil for Food program. Overall, the sanctions were effective in helping to prevent the Iraq regime from obtaining military items, but the UN was less rigorous in overseeing economic activities such as monitoring the price and value of Iraq's contracts. The UN's neglect of Iraq's illicit revenue streams helped support a sanctioned regime and undermined the goals of using oil revenues to benefit the Iraqi people.

The UN did not adequately address key internal control elements as it implemented the Oil for Food program. First, UN entities lacked clear lines of authority. For example, the Office of the Iraq Program lacked clear authority for rejecting commodity contracts based on pricing concerns. In addition, the customs contractor at Iraq's border was not authorized to evaluate imports for price and quality. Second, the UN did not assess emerging risks as the Oil for Food program expanded from a 6-month emergency measure to deliver food and medicine to a 6-year program providing more than \$31 billion to 24 economic sectors. Third, some monitoring activities constrained Iraq's ability to obtain illicit oil surcharges, but smuggling continued despite the presence of inspectors. In addition, the UN's internal audit office identified hundreds of weaknesses and irregularities in its reports. However, it lacked the resources and independence to provide effective oversight of this costly and complex UN effort.

The Oil for Food program offers several lessons for designing future sanctions and strengthening existing UN programs:

- Assess whether the sanctions program gives undue control to the sanctioned country.
- Consider the economic impact that sanctions have on neighboring countries.
- Ensure that all aspects of sanctions are equally enforced.
- Establish clear authority and responsibility for management, oversight, and monitoring activities.
- Assess and mitigate risk as programs and funding expand.
- Assess the role of internal oversight units and ensure that they have the resources and independence needed for effective oversight.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the lessons learned from the United Nations (UN) Oil for Food program and the implications for future sanctions programs and ongoing UN reform efforts.

In 1996, the UN and Iraq began the Oil for Food program to address growing concerns about Iraq's humanitarian situation after international sanctions were imposed in 1990. The intent of the program was to allow the Iraq government to use the proceeds of its oil sales to pay for food, medicine, and infrastructure maintenance and, at the same time, prevent the regime from obtaining goods for military purposes. Iraq obtained more than \$67 billion in oil revenues through the program; as of November 2003, about \$31 billion in commodities and humanitarian assistance had been delivered to Iraq.¹ Four key entities were responsible for most of the program's operations—the Security Council's Iraq sanctions committee, the UN Secretariat's Office of the Iraq Program, nine UN agencies with separate programs in northern Iraq, and the Iraqi government under Saddam Hussein.

The 2005 Defense Authorization Act mandated that GAO review the Oil for Food program² following allegations of corruption and misconduct. In April 2006, we issued a report on the results of our work and our recommendations for strengthened internal controls at the UN.³ We have also testified numerous times on the Oil for Food program and issued a report in May 2002 on the implementation of sanctions against Iraq.⁴ Today, I will discuss (1) the control environment established by the UN for managing the sanctions and Oil for Food program; (2) other key internal control elements addressed by the UN, including lines of authority and

¹The UN allocated 72 percent of Iraq's oil proceeds to humanitarian assistance for Iraq; it also allocated a portion of these proceeds to a compensation fund for paying reparations to victims of Iraq's 1990 invasion of Kuwait and to UN administrative expenses for administering the Oil for Food program and international sanctions.

²Public Law 108-375, Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, October 2004.

³GAO, *United Nations: Lessons Learned from Oil for Food Program Indicate the Need to Strengthen UN Internal Controls and Oversight*, [GAO-06-330](#) (Washington, D.C.: Apr. 25, 2006).

⁴GAO, *Weapons of Mass Destruction: U.N. Confronts Significant Challenges in Implementing Sanctions Against Iraq*, [GAO-02-625](#) (Washington, D.C.: May 23, 2002).

responsibility, risk assessment, and monitoring and oversight; and (3) our observations on the lessons learned from the Oil for Food program. To address these objectives, we used the body of work that GAO has completed on Iraq sanctions, the Oil for Food program, and UN oversight issues.

Policymakers and program managers are continually seeking ways to better achieve agencies' missions and program results and improve accountability for results. A key factor in helping to achieve such outcomes is appropriate internal control, which, if properly designed and implemented, provide reasonable assurance that objectives are being met. Internal controls also serve as the first line of defense in safeguarding assets and preventing fraud, waste, and abuse.⁵ Our April 2006 report used this internal control framework to identify the key weaknesses in enforcing sanctions against Iraq and implementing the Oil for Food program.

Summary

The UN—the Security Council, the Secretariat, and member states—established weak controls over the Oil for Food program from its beginning. Specifically, the UN allowed Iraq to control contract negotiations for imported commodities with little oversight, enabling the regime to obtain illicit funds through contract surcharges and kickbacks. The UN also did not take steps to address the economic impact that the sanctions had imposed on countries that depended on Iraqi trade. This undermined international support for sanctions and allowed Iraq to smuggle oil outside the Oil for Food program. Overall, the sanctions were effective in helping to prevent the Iraq regime from obtaining military or dual-use items, but the UN was less rigorous in overseeing economic activities related to the Oil for Food program such as monitoring the price and value of Iraq's contracts. The UN's neglect of Iraq's illicit revenue

⁵A general framework for internal controls is widely accepted in the international audit community and has been adopted by leading accountability organizations, including the International Organization of Supreme Audit Institutions, the U.S. Office of Management and Budget, and GAO. These standards use the internationally accepted *Internal Control-Integrated Framework* (September 1992) by the Committee of Sponsoring Organizations of the Treadway Commission. The first standard within this framework is the control environment, which provides the structure, discipline, and ethical tone for implementing an internal control system. Other standards focus on employing assessments of the external and internal risks an organization faces; establishing policies and procedures to enforce directives (control activities); providing relevant, timely, and reliable information and communication; and monitoring performance and adhering to audit findings.

streams from smuggling and kickbacks helped support a sanctioned regime and undermined the program's goal of using oil revenues to benefit the Iraqi people.

As the program was implemented, sanctions and the Oil for Food program were further weakened by inadequate attention to internal controls, including (1) establishing clear responsibility and authority, (2) identifying and addressing program risks, and (3) ensuring adequate monitoring and oversight. UN entities and contractors responsible for implementing and monitoring the program lacked clear lines of authority. For example, the Office of the Iraq Program lacked clear authority to reject commodity contracts based on pricing concerns. In addition, the UN contractor at Iraq's border was not authorized to evaluate imports for price and quality, and there were no provisions to stop imports not purchased through the Oil for Food program. Moreover, the UN did not assess emerging risks as the Oil for Food program expanded from a 6-month emergency measure to deliver food and medicine to a 6-year program that provided more than \$31 billion to Iraq's agriculture, electricity, oil, housing, and 20 other economic sectors. Some monitoring activities curtailed the ability of the regime to obtain illicit contract surcharges, but smuggling continued despite the presence of inspectors. Finally, the UN's internal audit office audited some aspects of the Oil for Food program and identified hundreds of weaknesses and irregularities. However, it lacked the resources and independence needed to provide full and effective oversight of this large, costly, and complex UN effort.

The Oil for Food program offers several lessons for designing future sanctions and strengthening existing UN programs:

- Assess whether the sanctions program gives undue control to the sanctioned country.
- Consider the economic impact that sanctions have on neighboring countries.
- Ensure that all aspects of sanctions are equally enforced.
- Establish clear authority and responsibility for key management, oversight, and monitoring activities.
- Continuously assess and mitigate risk as programs and funding expand.
- Assess the role of internal audit and evaluation units and take steps to ensure that these entities have the resources and independence needed for effective oversight.

In our April 2006 report on the Oil for Food Program, we recommended that the Secretary of State and the Permanent Representative of the United States to the UN work with other member states to encourage the Secretary General to (1) ensure that UN programs with considerable financial risks establish, apply, and enforce the principles of internationally accepted internal control standards, with particular attention to comprehensive and timely risk assessments; and (2) strengthen internal controls throughout the UN system, based in part on the lessons learned from the Oil for Food program. The Department of State and the UN responded that they are taking steps to strengthen internal controls at the UN.

The UN Established a Weak Control Environment for Enforcing Sanctions and Managing the Oil for Food Program

Although the sanctions curbed the Iraq regime's ability to advance its military and weapons of mass destruction programs, the UN established a weak control environment for the Oil for Food program at its beginning due to compromises it made with the Iraq government and neighboring states. For example, the UN allowed Iraq to control contract negotiations for imported commodities with little oversight, allowing the regime to obtain illicit funds through contract surcharges and kickbacks. Several countries in the region depended on Iraqi trade, but no provisions were made to address the economic impact of the sanctions on these countries. This undermined international support for sanctions and allowed Iraq to smuggle oil outside the Oil for Food program. The sanctions helped prevent the Iraq regime from obtaining prohibited military and dual-use items, but little attention was given to oversight of the economic activities related to the Oil for Food program, such as monitoring the price and value of Iraq's contracts. Allowing Iraq to obtain revenues outside the Oil for Food program undermined the goals of containing the regime and using its oil revenues for UN-managed assistance to benefit the Iraqi people.

Early Compromises Allowed Iraq to Set the Terms for Contracting and Monitoring

When the UN first proposed the Oil for Food program in 1991, it recognized the vulnerability inherent in allowing Iraq control over the contracting process. At that time, the Secretary General proposed that the UN, an independent agent, or the Iraqi government be given the responsibility to negotiate contracts with oil purchasers and commodity suppliers. However, the Secretary General subsequently concluded that it would be highly unusual or impractical for the UN or an independent agent to trade Iraq's oil or purchase commodities and recommended that Iraq negotiate the contracts and select the contractors. Nonetheless, he stated that the UN and Security Council must ensure that Iraq's

contracting did not circumvent the sanctions and was not fraudulent. Accordingly, the Security Council proposed that UN agents review the contracts and compliance at the oil ministry. Iraq refused these conditions.

By the mid-1990s, the humanitarian conditions had worsened. The UN reported that the average Iraqi's food intake was about 1,275 calories per day, compared with the standard requirement of 2,100 calories. In April 1995, the Security Council passed resolution 986 to permit Iraq to use its oil sales to finance humanitarian assistance. Against a backdrop of pressure to maintain sanctions while addressing emergency humanitarian needs, the UN conceded to Iraq's demand that it retain independent control over contract negotiations. Accordingly, a May 1996 memorandum of understanding⁶ between the UN and Iraq allowed Iraq to directly tender and negotiate contracts without UN oversight and to distribute imported goods to the intended recipients.

When the Oil for Food program began, the UN was responsible for confirming the equitable distribution of commodities, ensuring the effectiveness of program operations, and determining Iraq's humanitarian needs. According to the memorandum of understanding, the Iraqi government was to provide UN observers with full cooperation and access to distribution activities. However, observers faced intimidation and restrictions from Iraqi regime officials in carrying out their duties. According to a former UN official, observers could not conduct random spot checks and had to rely on distribution information provided by ministry officials, who then steered them to specific locations. The Independent Inquiry Committee⁷ reported that observers were required to have government escorts and cited various instances of intimidation and interference by Iraqi officials. The committee concluded that the limits placed on the observers' ability to ask questions and gather information affected the UN Secretariat's ability to provide complete field reports to the sanctions committee.

⁶*Memorandum of Understanding between the Secretariat of the United Nations and the Government of Iraq on the Implementation of Security Council Resolution 986 (1995)*, May 20, 1996.

⁷In April 2004, the UN established the Independent Inquiry Committee, headed by Paul Volcker, the former Chairman of the U.S. Federal Reserve, to investigate the administration and management of Oil for Food program. Its scope included investigating allegations of fraud and corruption on the part of UN officials, personnel, and agents that entered into contracts with the UN or with Iraq under the program.

UN Did Not Address the Economic Impact of Sanctions on Member Countries

Under Security Council resolutions, all member states had the responsibility for enforcing sanctions. For Iraq, the UN depended on neighboring countries to deter the importation of illicit commodities and smuggling. However, concessions to regional trade activity affected the sanctions environment and allowed the Iraqi regime to obtain revenues outside the Oil for Food program. Although oil sales outside the program were prohibited, the Security Council's Iraq sanctions committee did not address pre-existing trade between Iraq and other member states, and no provisions were made for countries that relied heavily on trade with Iraq. Illicit oil sales were primarily conducted on the basis of formal trade agreements. For example, trade agreements with Iraq allowed Jordan—a U.S. ally dependent on Iraqi trade—to purchase heavily discounted oil in exchange for up to \$300 million in Jordanian goods. Members of the sanctions committee, including the United States, took note of Iraq's illicit oil sales to its neighbors, but took no direct action to halt the sales or take steps against the states or entities engaged in them. In addition, successive U.S. administrations issued annual waivers to Congress exempting Turkey and Jordan from unilateral U.S. sanctions for violating the UN sanctions against Iraq.

According to U.S. government officials and oil industry experts, Iraq smuggled oil through several routes. Oil entered Syria by pipeline, crossed the borders of Jordan and Turkey by truck, and was smuggled through the Persian Gulf by ship. Syria received up to 200,000 barrels of Iraqi oil a day in violation of the sanctions. Oil smuggling also occurred through Iran. The Security Council authorized the Multinational Interception Force in the Persian Gulf, but, according to the Department of Defense, it interdicted only about 25 percent of the oil smuggled through the Gulf.⁸

Sanctions Enforcement Focused on Military Items, but Less Rigorous Oversight for Economic Activities Facilitated Iraq's Ability to Obtain Illicit Revenues

The UN's focus on screening military and dual-use items was largely effective in constraining Iraq's ability to import these goods through the Oil for Food program. Each member of the Security Council's Iraq sanctions committee had authority to approve, hold, or block any contract for goods exported to Iraq. The United States, as a member of the committee, devoted resources to conducting a review of each commodity contract. As a result, the United States was the Security Council member that most frequently placed holds on proposed sales to Iraq; as of May 2002, it was responsible for about 90 percent of the holds placed by the

⁸GAO-02-625.

Security Council. U.S. technical experts assessed each item in a contract to determine its potential military application and whether the item was appropriate for the intended end user. These experts also examined the end user's track record with such commodities. An estimated 60 U.S. government personnel within the Departments of State, Defense, Energy, and other agencies examined all proposed sales of items that could be used to assist the Iraqi military or develop weapons of mass destruction. In addition, the Department of the Treasury was responsible for issuing U.S. export licenses to Iraq. It compiled the results of the review by U.S. agencies under the UN approval process and obtained input from the Department of Commerce on whether a contract included any items found on a list of goods prohibited for export to Iraq for reasons of national security or nuclear, chemical, and biological weapons proliferation.

In addition to screening items imported by Iraq, the UN conducted weapons inspections inside Iraq until 1998, when international inspectors were forced to withdraw. Sanctions also may have constrained Iraq's purchases of conventional weapons, as we reported in 2002.⁹ In 2004, the Iraq Survey Group reported that sanctions had curbed Iraq's ability to import weapons and finance its military, intelligence, and security forces.

The UN's neglect of Iraq's illicit revenue streams from smuggling and kickbacks facilitated unauthorized revenue for a sanctioned regime and undermined the program's goal of using Iraqi oil revenues to benefit the Iraqi people. According to a report by Department of Defense contract experts, in a typical contract pricing environment, fair and reasonable commodity prices are generally based on prevailing world market conditions or competitive bids among multiple suppliers.¹⁰ Ensuring a fair and reasonable price for goods can mitigate the possibility of overpricing and kickbacks. The Security Council's Iraq sanctions committee and the Secretariat's Office of the Iraq Program (OIP) were responsible for reviewing commodity contracts under the Oil for Food program, but neither entity conducted sufficient reviews of commodity pricing and value. As a result, Iraq was able to levy illicit contract commissions and kickbacks ranging from about \$1.5 billion to about \$3.5 billion.

⁹Ibid.

¹⁰*Report on the Pricing Evaluation of Contracts Awarded under the Iraq Oil for Food Program*, submitted by the Joint Defense Contract Audit Agency and Defense Contract Management Agency OFF Pricing Evaluation Team (Washington, D.C.: Sept. 12, 2003).

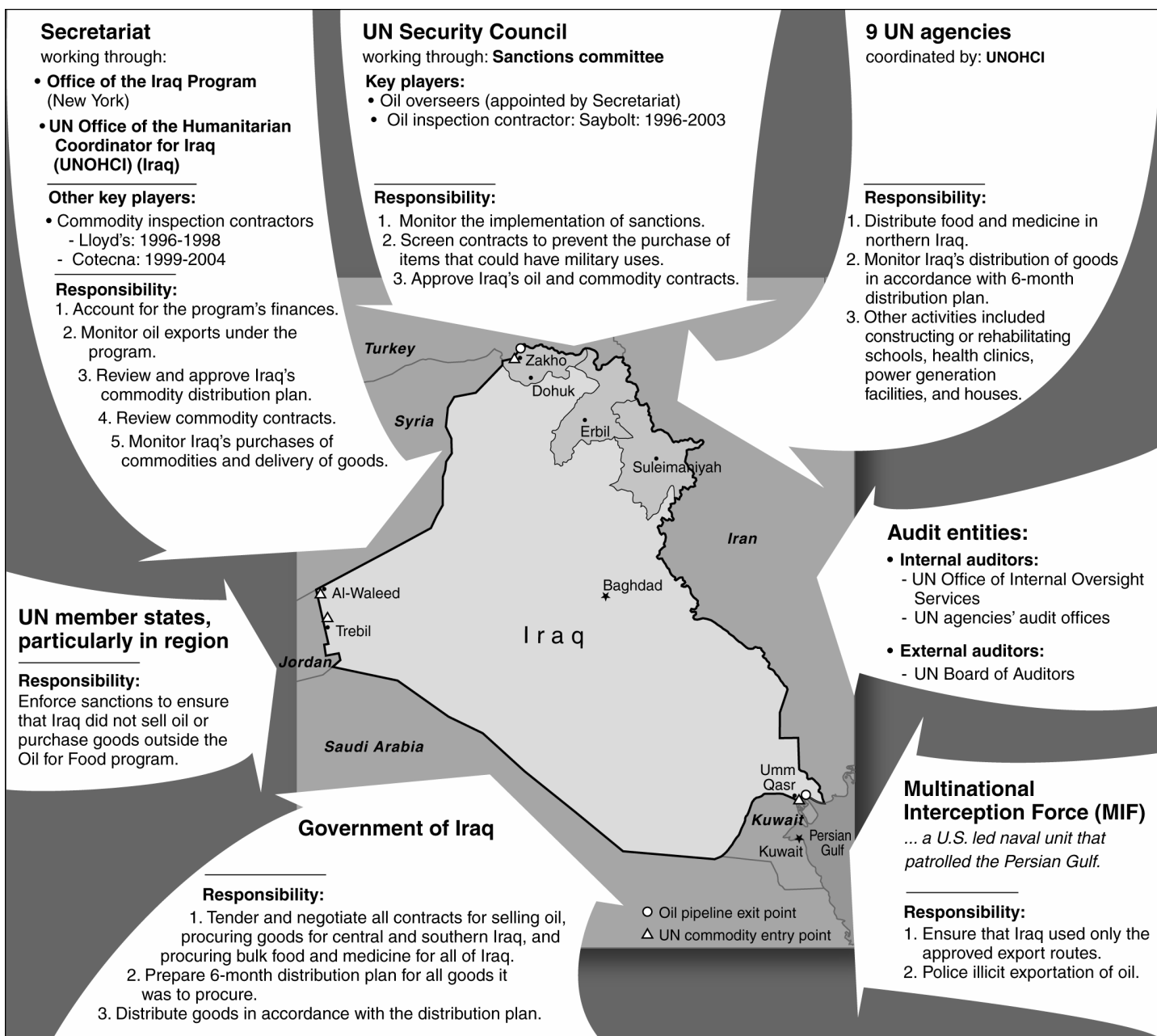
Unclear Authority, Lack of Risk Assessment, and Inadequate Monitoring and Oversight Further Undermined the Sanctions and Oil for Food Program

The UN did not adequately address other key internal control elements as it implemented the Oil for Food program: (1) establishing clear authorities, (2) identifying and addressing program risks, and (3) ensuring adequate monitoring and oversight. UN entities and contractors responsible for implementing and monitoring the program lacked clear lines of authority. For example, the Office of the Iraq Program lacked clear authority to reject commodity contracts based on pricing concerns. In addition, the UN contractor at Iraq's border did not have the authority to evaluate imports for price and quality, and no provisions were made to stop imports that were not purchased through the Oil for Food program. Moreover, the UN did not assess emerging risks as the Oil for Food program expanded from a 6-month emergency measure to deliver food and medicine to a 6-year program that provided more than \$31 billion to 24 economic sectors. Some monitoring activities constrained the ability of the regime to obtain illicit contract surcharges, but smuggling continued despite the presence of inspectors. Finally, the UN's internal audit office examined some aspects of the Oil for Food program and identified hundreds of weaknesses and irregularities. However, it lacked the resources and independence to provide effective oversight of this ambitious and complex UN effort.

Oil for Food Program Lacked Clear Lines of Responsibility and Authority

A good internal control environment requires that the agency clearly define and delegate key areas of authority and responsibility. Both OIP, as an office in the UN Secretariat, and the Security Council's Iraq sanctions committee were responsible for the management and oversight of the Iraq sanctions and Oil for Food program. The Iraq government, other UN agencies, UN member states, the interdiction force in the Persian Gulf, inspection contractors, and internal and external audit offices also played specific roles (see figure 1). However, no single entity was accountable for the program in its entirety. In 2005, the Independent Inquiry Committee reported that the Security Council had failed to clearly define the program's broad parameters, policies, and administrative responsibilities and that neither the Security Council nor the Secretariat had control over the entire program.

Figure 1: Multiple Organizations Managed the Oil for Food Program and Enforced UN Sanctions



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

The absence of clear lines of authority and responsibility were important structural weaknesses that further undermined the management and oversight of the Oil for Food program. For example, OIP was to examine each commodity contract for price and value before submitting it to the sanctions committee for approval. However, the Independent Inquiry Committee found that OIP lacked clear authority to reject contracts on pricing grounds and did not hire customs experts with the requisite expertise to conduct thorough pricing evaluations. In addition, UN inspectors did not have the authority to inspect goods imported into Iraq to verify price and quality. These inspectors mostly verified the arrival of goods in the country for the purpose of paying the contractor.

The Secretariat's contract for inspecting imports at three entry points in Iraq required inspection agents to "authenticate" goods, but the agents' responsibilities fell short of a more rigorous review of the imports' price and quality. Under the Oil for Food program, inspection agents compared appropriate documentation, including UN approval letters, with the commodities arriving in Iraq; visually inspected about 7 to 10 percent of the goods; and tested food items to ensure that they were "fit for human consumption." However, inspection agents were not required to (1) verify that food items were of the quality contracted, (2) assess the value of goods shipped, (3) inspect goods that were not voluntarily presented by transporters, or (4) select the items and suppliers or negotiate contracts. In addition, no provisions were made to interdict prohibited goods arriving at the border. According to Cotecna, the inspections contractor from 1999 to 2004,¹¹ "authentication" is not a standard customs term or function. The UN created the term for the Oil for Food program and did not include traditional customs inspection activities, such as price verification and quality inspection. In anticipation of an oil for food program, the UN selected Cotecna in 1992 for a program that was never implemented. Under that proposal, Cotecna would have verified fair pricing and inspected the quality of the items to help ensure that they conformed to contract requirements.

Finally, limited authority for contractors overseeing oil exports facilitated Iraq's ability to obtain illicit revenues from smuggling that ranged from \$5.7 billion to \$8.4 billion over the course of the Oil for Food program. In

¹¹The Coalition Provisional Authority used Cotecna from November 2003, when it assumed responsibility from the UN for remaining Oil for Food contracts, until October 2004, when the Iraqis no longer used independent inspection agents.

1996, the Secretariat contracted with Saybolt to oversee the export of oil from Iraq through selected export points. The inspectors were to monitor the amount of oil leaving Iraq under the Oil for Food program at these locations and to stop shipments if they found irregularities. The inspectors worked at two locations—the Ceyhan-Zakho pipeline between Iraq and Turkey and the Mina al-Bakr loading platform in southern Iraq. In 2005, a Saybolt official testified that its mandate did not include monitoring all oil exports leaving Iraq from other locations or acting as a police force.¹² As a result, the contractors did not monitor oil that was exported outside the Oil for Food program.

Program Risk Was Not Continuously Identified and Addressed

Risk assessments can identify and manage the internal and external challenges affecting a program's outcomes and accountability, including those risks that emerge as conditions change. The Oil for Food program expanded rapidly as it evolved from an emergency 6-month measure to provide humanitarian needs to a 6-year program that delivered about \$31 billion in commodities and services in 24 sectors. Beginning in 1998, when the international community was not satisfied with Iraq's compliance with weapons inspections, the Security Council continued the sanctions and expanded its initial emphasis on food and medicines to include infrastructure rehabilitation and activities in 14 sectors. These sectors included food, food handling, health, nutrition, electricity, agriculture and irrigation, education, transport and telecommunications, water and sanitation, housing, settlement rehabilitation for internally displaced persons, demining, a special allocation for vulnerable groups, and oil industry spare parts and equipment. In June 2002, the Iraqi government introduced another 10 sectors, including construction, industry, labor and social affairs, youth and sports, information, culture, religious affairs, justice, finance, and the Central Bank of Iraq.

The Security Council and UN Secretariat did not assess the risks posed by this expansion, particularly in light of the fact that they had allowed the Iraqi government to tender and negotiate its contracts. The UN Office of Internal Oversight Services (OIOS) was the only entity that attempted to assess the enormous risks in the Oil for Food program, but OIP blocked that attempt. In August 2000, the Under Secretary General for OIOS

¹²Testimony of John Denson, General Counsel, Saybolt Group, before the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate (Washington, D.C.: Feb. 15, 2005).

proposed an overall risk assessment to the Deputy Secretary General to improve the program by identifying the factors that could prevent management from fulfilling the program's objectives. The proposal noted that this assessment could be a model for other UN departments and activities. OIOS considered the Oil for Food program a high-risk activity and decided to focus on an assessment of OIP's Program Management Division. This unit was responsible for providing policy and management advice to OIP's executive director and for supporting OIP's field implementation and observation duties. In May 2001, OIP's executive director refused to fund the risk assessment, citing financial reasons and uncertainty over the program's future.

In July 2003, OIOS issued an assessment of OIP's Program Analysis, Monitoring, and Support Division—formerly the Program Management Division—that identified a number of organizational, management, and administrative problems, including poor communication and coordination, unclear reporting lines among OIP headquarters units and the field, and the lack of approved work plans. However, by this date, the UN was preparing for the November 2003 transfer of the program to the Coalition Provisional Authority in Iraq, and the report was of limited usefulness for addressing high-risk areas. Comprehensive and timely risk assessments might have identified the internal control weaknesses—such as inadequate contract pricing reviews—that facilitated Iraq's ability to levy illicit contract revenues. These assessments also might have identified the structural management weaknesses that led to ineffective communication and coordination within the program.

Oil Export Monitoring Activities Did Not Deter Smuggling but Did Mitigate Contract Surcharges

Ongoing monitoring and specific control activities should meet the management and oversight needs of the agency or program. However, during the Oil for Food program, the lack of functioning oil meters enabled the Iraqi government to smuggle oil undetected by inspectors. A Saybolt employee testified that the company notified UN officials of the problems posed by the lack of functioning meters at the beginning of the program.¹³ He also testified that the lack of metering equipment allowed the two "topping off" incidents involving the oil tanker Essex, in which the tanker loaded additional oil after the inspectors had certified the loading and left

¹³Testimony of John Denson, General Counsel, Saybolt Group, before the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate (Washington, D.C.: Feb. 15, 2005).

the vessel. In November 2001, a Saybolt representative noted that Iraq's distribution plans for that period provided for the installation of a meter at the Mina al-Bakr port. A U.S. official called for OIP to develop a plan to prevent unauthorized oil sales that would include installing a meter at the port. However, Iraq did not tender a contract for the meter. As of March 2006, the Iraqi government has not yet installed oil meters at Mina al-Bakr.

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

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

UN Internal Audit Office Lacked Sufficient Resources and Independence to Provide Effective Oversight

Ongoing monitoring of internal control should include activities to help ensure that the findings of audits and other evaluations are promptly resolved. Although OIOS conducted dozens of audits of the Oil for Food program, the office did not review key aspects of the Oil for Food program and had insufficient staff. OIOS did not review whether OIP was adequately monitoring and coordinating the Oil for Food program, including OIP's role in assessing commodity pricing. OIOS did not examine OIP's oversight of the commodity contracts for central and southern Iraq, which accounted for 59 percent of Oil for Food proceeds. According to the Independent Inquiry Committee, the internal auditors believed that they did not have the authority to audit humanitarian contracts because the sanctions committee was responsible for contract approval.

OIP management mostly supported OIOS audits for program activities in northern Iraq managed by other UN agencies; however, these northern programs constituted only 13 percent of the Oil for Food program. Because OIOS did not review commodity contracts, it was difficult to quantify the extent to which the Iraqi people received the humanitarian assistance funded by its government's oil sales. The Independent Inquiry Commission noted that the practice of allowing the heads of programs the right to fund internal audit activities led to excluding high-risk areas from internal audit examination. We also found that UN funding arrangements constrain OIOS's ability to operate independently as mandated by the General Assembly and as required by the international auditing standards to which OIOS subscribes.¹⁴ The UN must support budgetary independence for the internal auditors.

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

OIOS also encountered problems in its efforts to widen the distribution of its reporting beyond the head of the agency audited. In August 2000, OIOS

¹⁴GAO, *United Nations: Funding Arrangements Impede Independence of Internal Auditors*, [GAO-06-575](#) (Washington, D.C.: Apr. 25, 2006).

proposed sending its reports to the Security Council. However, the OIP director opposed this proposal, stating that it would compromise the division of responsibility between internal and external audit. In addition, the UN Deputy Secretary General denied the request, and OIOS subsequently abandoned any efforts to report directly to the Security Council. Timely reporting on audit findings would have assisted the Security Council in its oversight of Iraq sanctions and the Oil for Food program.

Concluding Observations: Lessons Learned from the Oil for Food Program

Our findings on UN management of Iraq sanctions and the Oil for Food program reveal a number of lessons that can apply to future sanctions and should be considered during the ongoing debate on UN reform. These lessons demonstrate the importance of establishing a good control environment at the outset. In addition, fundamental internal control activities must be applied throughout the life of UN programs. Specifically,

- When establishing the program, assess the roles and authorities of the sanctioned country. If political pressures and emergency conditions dictate significant authority and responsibilities for the sanctioned country, assess the risks posed by these authorities and take steps to mitigate potential problems. A comprehensive risk assessment following the decision to allow Iraqi control over contracting and monitoring might have revealed the need for more rigorous activities to review the prices the regime charged and the quality of goods it contracted to prevent or help lessen the opportunity for illicit charges.
- Consider the impact that the loss of trade might have on surrounding countries. For example, Jordan, a U.S. ally, was allowed to continue buying Iraqi oil outside the Oil for Food program, which facilitated the revenue that Iraq could obtain beyond UN control. Other provisions for obtaining discounted oil might have prevented this trade.
- Ensure that monitoring and oversight equally address all program goals. Although the UN focus on screening military and dual-use items was largely effective in constraining Iraq's ability to import these goods through the Oil for Food program, the UN's neglect of Iraq's illicit revenue streams from smuggling and kickbacks undermined the program's goal of using Iraqi oil revenues to benefit the Iraqi people.
- Establish clear authorities for key management, oversight, and monitoring activities. The Oil for Food program had unclear lines of authority for rejecting contracts based on price and value concerns and for inspecting imported goods and exported oil. These important structural weaknesses allowed the sanctioned Iraq regime significant control over program activities.

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- As programs and funding expand, continuously assess the risks caused by this expansion and take steps to ensure that resources are safeguarded. The UN did not assess risks as the Oil for Food program grew in size and complexity, particularly in light of the fact that it had relegated responsibility for the contracting process to Iraq. Timely risk assessments might have identified the internal control weaknesses that facilitated Iraq's ability to levy illicit contract revenues and thereby undermine the UN's goal of using Iraq's oil proceeds for humanitarian assistance to the Iraqi people.
 - Assess the role of internal audit and evaluation units and take steps to ensure that these entities have the resources and independence needed for effective oversight. Although the UN's internal audit office audited some aspects of the Oil for Food program and identified hundreds of irregularities, it lacked the resources and independence to provide effective oversight of this costly and complex UN effort.

Recommendation

In our report on the Oil for Food program's internal controls,¹⁵ we recommend that the Secretary of State and the Permanent Representative of the United States to the UN work with other member states to encourage the Secretary General to

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

Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. I will be happy to answer any questions you may have.

Contacts and Acknowledgments

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¹⁵ [GAO-06-330](#).

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