

INDEPENDENT INQUIRY COMMITTEE  
— INTO —  
THE UNITED NATIONS OIL-FOR-FOOD PROGRAMME

THE MANAGEMENT OF  
THE UNITED NATIONS OIL-FOR-FOOD PROGRAMME

Volume I - The Report of the Committee

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September 7, 2005  
[www.iic-offp.org](http://www.iic-offp.org)

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## **VOLUME I - PREFACE TO REPORT OF THE COMMITTEE**

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### **PREFACE**

In April of 2004, the Independent Inquiry Committee was charged by the Secretary-General and the Security Council with the task of thoroughly reviewing the management of the United Nations Oil-for-Food Programme.

That Programme was certainly the largest, most complex, and most ambitious humanitarian relief effort in the history of the United Nations Organization. In the Programme's administration, the Organization had to deal with a mixture of political, security, financial, and economic concerns. Almost every part of the United Nations family was involved, beginning with the Security Council, the central Secretariat under the Secretary-General, and nine of the UN-related Agencies, with varying degrees of financial and operational independence.

The Committee Report provides a broad and intensive review and analysis of the Programme. It reflects more than a year's work by dozens of experienced attorneys, seasoned investigators, and forensic specialists drawn from twenty-eight countries. Constraints of time, concerns for personnel security in Iraq, and lack of full cooperation by some member states and individuals, means that examination of some parts of the Programme has been less detailed than others. However, the Committee firmly believes that its investigation and this Report provide a solid base for fairly evaluating the Programme's administration. Moreover, given the breadth of the Programme, and the involvement of so many arms of the United Nations, the difficulties encountered—the politicization of decision-making, the managerial weaknesses, the ethical lapses—are symptomatic of systemic problems in United Nations administration. Consequently, the lessons drawn are broadly applicable to the Organization as a whole.

The main conclusions are unambiguous.

The Organization requires stronger executive leadership, thoroughgoing administrative reform, and more reliable controls and auditing.

At stake is the United Nations' ability to respond promptly and effectively to the responsibilities thrust upon it by the realities of a turbulent, and often violent, world. In the last analysis, that ability rests upon the Organization's credibility—on maintaining a widely-held perception among member states and their populations of its competence, honesty, and accountability.

It is precisely those qualities that too often were absent in the administration of the Oil-for-Food Programme.

Conceived as a means for reconciling strong sanctions against a corrupt Iraqi regime with needed supplies of food and medicines to an innocent and vulnerable population, the Programme did achieve important successes. Its existence helped maintain the international effort to deprive Saddam Hussein of weapons of mass destruction. Furthermore, a new study commissioned by the Committee confirms that minimal standards of nutrition and health were maintained in the face of a potential crisis.

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Those were real accomplishments. They were achieved despite uncertain, wavering direction from the Security Council, pressures from competing political forces in Iraq, and endemic corruption on the ground.

Sadly, those successes fell under an increasingly dark shadow. As the years passed, reports spread of waste, inefficiency, and corruption, even within the United Nations itself. Some was rumor and exaggeration, but much—too much—has turned out to be true.

The Committee Report documents how differences among member states impeded decision-making, tolerated large-scale smuggling, and aided and abetted grievous weaknesses in administrative practices within the Secretariat. An adequate framework of controls and auditing was absent. There were, in fact, instances of corruption among senior staff as well as in the field. As a result, serious questions have emerged about the United Nations' ability to live up to its ideals.

One perspective is that the United Nations Organization was simply asked to do too much, too soon, without any clear sense of how long the Programme would continue; it was authorized only in six-month increments. As time passed, the huge flow of funds far exceeded that of ordinary United Nations operations. Thousands of staff were hired and deployed in the field, overtaking weak management oversight and accountability.

The Committee's investigation clearly makes the point that, as the Programme expanded and continued, Saddam Hussein found ways and means of turning it to his own advantage. For the UN-related Agencies, the work went beyond their core competencies—from monitoring, planning, and consulting—to rebuilding of infrastructure, thereby multiplying problems. Nor was there much success in coordinating so large a program among the Agencies, which are accustomed to defending zealously their individual autonomy.

In the light of those failures, the Committee has asked itself a simple question: Should the United Nations—the Secretariat and its Agencies—simply put their collective feet down, and refuse to take on such costly and complicated operational programs for which it is ill-equipped?

Of course, a realistic answer cannot be so simple. Fresh emergencies, cutting across particular agency missions will surely recur. Differences in political priorities among members of the Security Council are a fact of life. In the absence of the United Nations, no other organization or nation, or no grouping of organizations or nations, may be readily available, or available at all, to take on the complex missions cutting across national boundaries and diverse areas of competence. And, singly or together, the Agencies do have skills and experience—and a presumption of legitimacy—difficult or impossible to match.

Interestingly, in at least one large area, peacekeeping and nation-building, the United Nations is called upon more and more frequently. The “blue helmets” do convey a sense of international legitimacy, and the United Nations over time has built some infrastructure and professional management. In the case of the Oil-for-Food Programme, no similar structure, no adequate capacity for planning within or among the Agencies, and no adequate control or auditing framework was in place.

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The basic lessons the Committee has drawn from its review are both pointed and broad. In sum:

1. However well-conceived the Programme was in principle, the Security Council failed to define clearly the practical parameters, policies, and administrative responsibilities. Far too much initiative was left to the Iraqi regime in the Programme's design and subsequent implementation. Compounding that difficulty, the Security Council, in contrast to most past practice, retained within its own sanctions committee of national diplomats substantial elements of operational control. Neither the Security Council nor the Secretariat leadership was clearly in command. That turned out to be a recipe for the dilution of Secretariat authority and evasion of personal responsibility at all levels. When things went awry—and they surely did—when troublesome conflicts arose between political objectives and administrative effectiveness, decisions were delayed, bungled, or simply shunned.
2. The administrative structure and the personnel practices of the Organization—certainly within the Secretariat—were simply not fit to meet the truly extraordinary challenges presented by the Oil-for-Food Programme, or even programs of much lesser scope. The Committee Reports reveal serious instances of illicit, unethical, and corrupt behavior within the United Nations, but the pervasive administrative difficulties were not only, or even primarily, related to personal malfeasance. As will become evident in the Committee's next, and final, report, the wholesale corruption within the Programme took place among private companies, manipulated by Saddam Hussein's government.

The United Nations Charter designates the Secretary-General as Chief Administrative Officer. Whatever the founders had in mind, the Secretary-General—*any* Secretary-General—has not been chosen for his managerial or administrative skills, nor has he been provided with a structure and instruments conducive to strong executive oversight and control. That is most clearly evident in the area of personnel management, where professional competence must compete with, and often take second place to, the narrow political interests of member states.

The reality is that the Secretary-General has come to be viewed as chief diplomatic and political agent of the United Nations. The present Secretary-General is widely respected for precisely those qualities. In these turbulent times, those responsibilities tend to be all consuming. The record amply reflects consequent administrative failings.

3. Most notable among the United Nations' structural faults is a grievous absence of effective auditing and management controls. In both areas, the General Assembly has taken steps to develop competence and accountability, but that belated effort has fallen far short of what is needed. The Oil-for-Food Programme has exposed chronic weakness of planning, sorely inadequate funding, and the simple absence of enough professional personnel to implement controls and auditing. That remained true even as the Programme grew exponentially in its financial magnitude, eclipsing in size ordinary United Nations operations. As important was the palpable absence of



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authority for the auditors and the lack of clear, if any, reporting lines to “the Top.” As a consequence, needed independence was absent. Line managers could and did divert auditing initiatives. Follow-up to critical findings was erratic or non-existent.

4. The isolated instances of corruption detailed in the earlier Committee Reports extend to the top of the Programme administration—one important reflection of the managerial weaknesses. Those egregious lapses signal the absence of a sufficiently strong organizational ethic—an ethic that should permeate its leadership and staff if the United Nations is to command the respect upon which its work depends.

Corrosive corruption—private and public—has been far too common, not least in member states in which the United Nations has programs of economic and humanitarian assistance. In that environment, the evidence clearly demonstrates that the General Assembly, the Security Council, and the Secretariat management have been insufficiently conscious of the need to seize the Organization’s unique opportunity to exemplify and encourage the highest standards of conduct in international affairs.

5. Finally, the particular nature of the Oil-For-Food Programme placed in stark relief the difficulties of effective cooperation among United Nations Agencies. There was and is no simple way accurately to track Programme expenditures across agency lines. The presumption of central budgetary authority for the Oil-for-Food Programme was not matched by an ability to assess actual spending (much less the effectiveness of spending), or to insist on uniform accounting standards or treatment. Surely the difficulties perceived should not be tolerated in any other programs, however large or small.

The inescapable conclusion from the Committee’s work is that the United Nations Organization needs thoroughgoing reform—and it needs it urgently.

That is not surprising. It is a central point in all recent studies of the United Nations, including those initiated by the Secretary-General himself.

The work of the Independent Inquiry Committee into the United Nations Oil-for-Food Programme does bring new dimensions to the discussion. Its investigation is unprecedented in its breadth and depth. It has involved not only the Security Council and the Secretariat in New York, but has touched directly upon nine other members of the United Nations family.

The urgent need for action can be summarized in four broad recommendations:

- The Security Council, in making decisions about United Nations intervention in critical areas, should *clarify each program’s purpose and criteria*. The *execution* should be delegated to the Secretariat and appropriate Agencies, with clear lines of reporting responsibility.

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- To provide the *needed focus for the administrative responsibilities* of the Secretariat, there should be a Chief Operating Officer (“COO”), nominated by the Security Council and approved by the General Assembly. While ultimately reporting to the Secretary-General, the new COO should have access to the Security Council, and should have clear authority for planning and for personnel practices that emphasize professional and administrative talent over political convenience.
- A strong “*Independent Auditing Board*,” with adequate staff support, must be built. That Board should go well beyond financial audits to full review of the staffing and budgeting of accounting and auditing services. Auditing, control, and investigatory staffs should have direct access to that Board and be subject to its oversight.
- In programs extending over more than one agency, *effective coordination* should be required from the start by clear and agreed memoranda of understanding and enforced by common accounting and auditing standards.

Most of these measures could be accomplished by decision of the General Assembly, the Security Council, the Secretariat, and the individual Agencies. But if changes in the Charter are required to implement reform and to *underscore* its importance, then member states should not shrink from that effort.

What is important—*what has been recognized by one investigation after another*—is that real change take place, and change over a wide area.

Clear benchmarks for measuring progress must be set. The General Assembly should insist, in its forthcoming meeting, that key reforms be put in place no later than the time of its regular meeting in 2006.

To settle for less, to permit delay and dilution, will invite failure, further erode public support, and dishonor the ideals upon which the United Nations is built.

The time for action is now.



Paul A. Volcker  
Chairman



Richard J. Goldstone  
Member



Mark Pieth  
Member

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*Henceforth, the most comprehensive coercive economic measures ever devised by the UN were tempered by the largest humanitarian relief operation in the UN's history.*

Netherlands Ambassador to the United Nations, Peter van Walsum,  
661 Committee Chair (1999-2000).

*Yesterday's Iraqi oil agreement was a great plus for the UN and you personally. Congratulations. But a word of caution! The story the press will be looking for next is how Saddam Hussein circumvents the agreement and diverts the oil for his own, or military, use. It will be critical for the UN's monitoring of the agreement, and delivery of medical aid to the needy, to be watertight. If there are flaws, the story will quickly turn negative.*

Note to Secretary-General Boutros Boutros-Ghali from an adviser on May 21, 1996, the day after signing of the agreement between Iraq and the United Nations to start the Oil-for-Food Programme.

## I. INTRODUCTION

A temporary United Nations program to provide urgent humanitarian relief to Iraq stretched to seven years and more than \$100 billion in transactions (over \$64 billion in oil sales and almost \$37 billion for food, medicines, and equipment). A rising chorus of complaints and allegations of corruption and maladministration led the Secretary-General—with the support of the Security Council—to appoint a committee to conduct an independent inquiry.

The three-member Independent Inquiry Committee (Paul A. Volcker, Chair, and Justice Richard J. Goldstone and Prof. Mark Pieth, Members),<sup>1</sup> supported by an international staff of over seventy-five investigators, lawyers, forensic accountants, and support personnel, thus came into being.

At the time of their appointment, the Committee members well appreciated the magnitude of what they were called upon to do. In the words of the Committee's Chair, Paul Volcker:

Each of us well understands that serious charges so widely aired could threaten the effectiveness of the UN in contributing to a constructive resolution of the

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<sup>1</sup> Short biographies of the Committee members are attached as Annex 1 to this Chapter.

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Iraqi situation and in other areas. It is the need for prompt, convincing, and truthful responses to these charges which leads to our willingness to respond positively to your invitation to serve on the Committee.

Equally, the Committee was fully cognizant that the seriousness of the allegations swirling about the Oil-for-Food Programme demanded an inquiry that was efficient and comprehensive, yet fair and impartial towards each individual and entity within the scope of the investigation. The Committee members were also mindful of the need for full disclosure of the Committee's findings, for cooperation with other official inquiries within the limits imposed by investigative requirements, and for providing the international community with a full and accurate accounting of what occurred within the Programme.

Consistent with the Committee's mandate,<sup>2</sup> the central issues to be addressed were:

1. Whether there was mismanagement and maladministration in the execution of the Programme by the United Nations, its personnel, and agents;
2. Whether any United Nations officials, personnel, or agents engaged in any illicit or corrupt activities in connection with the Programme; and
3. Whether contractors of the United Nations, purchasers of oil, or providers of humanitarian aid engaged in any illicit or corrupt activities in connection with the Programme.

As this Report amply demonstrates, the answer to each of these questions is yes. But that simple answer cannot convey the virtually unprecedented complexities of the challenge presented to the United Nations, nor the magnitude of what was actually accomplished. Moreover, this Report contains criticisms of the actions of certain United Nations officials. However, the Committee is well aware that a great many United Nations staff members performed their responsibilities with devotion and diligence amidst considerable challenges posed by the size of the Programme and, at times, defiance from the former Government of Iraq.

Given its mandate, it should not be surprising that the Committee's conclusions and recommendations focus on the Programme's flaws and weaknesses. Based partly on a study commissioned by the Committee to test the premises of the Programme,<sup>3</sup> and partly on its investigation, it is clear to the Committee that the Programme achieved considerable successes, notably in maintaining minimal standards of nutrition and health. The Programme also contributed to the maintenance and longevity of sanctions against Iraq, helping to ensure that Iraq would not obtain weapons of mass destruction.

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<sup>2</sup> See Annex 2 to this Chapter.

<sup>3</sup> A summary is provided as Annex 4 to this Chapter.

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However, success came at substantial cost. From the outset, Iraq, ever desirous of ways to lighten or remove the sanctions, tried to manipulate political differences within the Security Council. The Iraqi regime siphoned off substantial funds. Companies, registered with national governments for the purpose of doing business under the Programme, were complicit in providing illicit payments to Iraq. There was corruption within the United Nations at a critical management point. There was exposure of important administrative and control weaknesses both within the United Nations Secretariat and among the constituent parts of the United Nations family operating in Iraq. The consequences? An avoidable loss of assistance to Iraq's population and a grievous loss of credibility to the United Nations.

The Committee began work in May 2004 and will conclude its investigation in October 2005. In the course of its investigation, the Committee has interviewed over 1,100 individuals, companies, and governments in many countries on six continents. It has collected over twelve million pages of documents, both paper and electronic. The vast majority of these documents originated with the United Nations, but governments and private third parties provided approximately a half million such documents. By the conclusion of its work, the Committee will have issued eight reports or briefing papers, of which this Report is the seventh.

At the outset of its work, the Committee requested, and received, an instruction from the Secretary-General to all United Nations staff requiring their cooperation with the Inquiry. In the main, United Nations staff members have responded positively. On those rare occasions where there has been an initial reluctance to respond, it usually has been possible to resolve the matter to the Committee's satisfaction.

In this last context, Security Council Resolution 1538 welcomed the Committee's appointment and, *inter alia*, called "upon the Coalition Provisional Authority, Iraq, and all other member states including their national regulatory authorities, to cooperate fully by all appropriate means with the inquiry." The Committee has sought the cooperation of various governments and their law enforcement and regulatory bodies. The Committee has worked closely with a wide range of national regulatory and law enforcement bodies and has received considerable help from numerous governments.<sup>4</sup> Among the latter, the Committee wishes, in particular, to note the help it has received from the Governments of Iraq which have succeeded the CPA, despite the violent and volatile conditions in that country.

France, Switzerland, and the United Kingdom have furnished substantial cooperation. There have also been several instances in which the Committee has received little or no help from governments or their internal agencies. Russia and China, while receiving investigators in their capitals, have not granted requests for important information and have refused to arrange access to some state-owned companies of interest to the Inquiry. The Committee has received

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<sup>4</sup> For specifics on the cooperation received from different countries, see the Investigation Preface in Volume II of this Report.

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significant assistance from the United States federal government through the United States Mission to the United Nations, and from the Department of State, and, at the state level, from the New York County District Attorney's Office. Other organs of the United States federal government have refused cooperation.

This Report focuses particularly on the management and oversight of the Programme amidst the Programme's manipulation by Iraq. While not every aspect of the Programme could be examined in the same detail (as, for example, operations on the ground in Iraq), the Committee has a firm basis for reaching its conclusions leading to important recommendations. It also calls to account those involved who were found to be corrupt, broke the rules, or contributed to the Programme's maladministration, wherever they are found, be it the top or the bottom of the Organization, inside or outside of the United Nations Secretariat.<sup>5</sup>

The Committee recognizes that United Nations staff administering the Programme were operating within an institutional structure that had not kept pace with the expansion of the scope of United Nations operations and the demands made on the Organization. This consideration is reflected in the Committee's conclusions and recommendations.

So far as management of the Programme was concerned, the Secretariat's role and responsibility for the administration of the Programme must be viewed within the framework of the actions of the United Nations Security Council. The Security Council designed and outlined the basic requirements of the Programme. It charged its Iraq sanctions committee (known as "the 661 Committee"), which was made up of diplomats from each of the Security Council member states, with the monitoring of sanctions observance as well as primary supervision and operational approval of most transactions taking place under the Programme.

Specifically, under the Programme, the 661 Committee enacted rules for the review and approval of contracts, approved the price at which oil was sold, and reviewed individual contracts for humanitarian goods. To a significant degree, reports of Iraq's manipulation of the Programme were not redressed by the Security Council or the 661 Committee.

As the Chief Administrative Officer of the United Nations, the Secretary-General carried out oversight and management responsibilities for the entire Secretariat. That particularly included auditing and controls functions that had demonstrable problems with respect to the Programme, as discussed elsewhere in this Report.

The Secretariat—and, in particular, the Office of Iraq Programme ("OIP") headed by Executive Director Benon Sevan—had significant responsibilities to implement and administer the

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<sup>5</sup> The Committee's conclusions and findings are detailed throughout this Report. The findings are also listed in Annex 3 to this Chapter. The Committee's major recommendations are presented in Part XII of this Chapter, and recommendations are addressed further in Chapter 6 of Volume IV.

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Programme, responsibilities that in some material places intersected with the role and activities of the Security Council and its 661 Committee. This Report describes at length the large number of failures of Mr. Sevan in his duty to report and respond to information of violations of the sanctions against Iraq and of the rules governing transactions under the Programme.

As problems arose with the Programme, the Secretary-General and the Deputy Secretary-General were reluctant to recognize their own responsibility for the Programme's shortcomings. They did not ensure that critical evidence was brought to the attention of the Security Council and the 661 Committee. Moreover, they made minimal efforts to address sanctions violations with Iraqi officials, and they inadequately oversaw the activities of Mr. Sevan and OIP in the administration of more than \$100 billion of transactions under the Programme.<sup>6</sup>

In sum, in light of these circumstances, the cumulative management performance of the Secretary-General and the Deputy Secretary-General fell short of the standards that the United Nations Organization should strive to maintain. In making these findings, the Committee has recognized both the difficult administrative demands imposed upon the Secretariat and the Secretary-General both by the design of the Programme, and the overlapping Security Council responsibilities.

One chapter of this Report returns to the award to Cotecna Inspection S.A.—a company that employed Kojo Annan, the son of the Secretary-General—of a Programme contract to conduct inspections of humanitarian goods entering Iraq.<sup>7</sup> Since a prior report by the Committee on this issue, investigations have gone forward to determine whether Kojo Annan was involved with the Programme. In addition, new information emerged that, taken at face value, bore directly on the question of whether the Secretary-General was aware that the firm employing his son was actively bidding for a United Nations inspection contract.

The Committee carefully reviewed additional telephone billing records of Kojo Annan that make clear that, in the autumn of 1998, Kojo Annan placed calls to the United Nations procurement department and that, at other times, he also called the Secretary-General. However, the pattern of calling times is not clearly suggestive that Kojo Annan discussed Cotecna's interest with the Secretary-General. The remaining documents newly disclosed by Kojo Annan do not reflect communications between Kojo Annan and the Secretary-General about Cotecna's contract bid.

With respect to a memorandum of December 4, 1998 that was written by Michael Wilson of Cotecna, its description of "discussions" with the "SG and his entourage" about Cotecna's contract bid has not been corroborated. The witnesses do not support Mr. Wilson's account, and he himself has refuted it. This supports the Secretary-General's denial that such a meeting

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<sup>6</sup> For the investigative report on these matters, see Chapters 1 to 6 of Volume III of this Report.

<sup>7</sup> Independent Inquiry Committee, "Second Interim Report" (Mar. 29, 2005) (hereinafter "Second Interim Report").



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occurred. Moreover, there is no evidence that Cotecna credited or acted upon Mr. Wilson's message. Serious questions persist about the character and credibility of Mr. Wilson. The Committee therefore has little assurance that he did not conjure an account of discussions with the Secretary-General in order to make himself appear more important to his principals at Cotecna.

The Committee therefore affirms its prior finding that, weighing all of the evidence and the credibility of witnesses, the evidence is not reasonably sufficient to show that the Secretary-General knew that Cotecna had submitted a bid on the humanitarian inspection contract in 1998.

The Committee also affirms its prior finding that no credible evidence exists that the Secretary-General influenced, or attempted to influence, the procurement process in 1998 leading to the selection of Cotecna.

As to the adequacy of the Secretary-General's response to press reports in January 1999 of a possible conflict of interest, the Committee reemphasizes its earlier conclusion that the Secretary-General was not diligent and effective in pursuing an investigation of the procurement of Cotecna. What is now known about Kojo Annan's efforts to intervene in the procurement process underscores the Committee's prior finding that a thorough and independent investigation of the allegations regarding Kojo Annan's relationship with Cotecna was required in 1999. An investigation likely would have resolved the issues arising from the Cotecna bid process and the consequent conflict-of-interest concerns.

The Inquiry's investigation of Programme administration has been less intensive on the ground in Iraq. Largely due to the disturbed conditions in Iraq, it has not been possible to access witnesses or review financial records (where they exist) to the extent the investigation believed warranted. In fact, given the size and complexity of the Programme, it is doubtful that the Inquiry would have been able to render a full accounting within the timeframe of the work in Iraq, even in ideal conditions. However, the Committee has gathered sufficient information to comment on organizational and management gaps and lapses on the part of the United Nations and its Agencies and on the prejudicial behavior of Saddam Hussein's government in relation to the Programme. The details of outright corruption by contractors will be dealt with in the Committee's final report in October, which will describe how companies doing business under the Programme acquiesced in Iraqi demands for surcharges on oil contracts and kickbacks on humanitarian goods contracts.

The Committee believes that its comments, criticisms, conclusions, and recommendations will be, and should be, seen against the wider canvas of United Nations reform. Moreover, the Committee's conclusions and the recommendations arising from them, are generally consonant with recommendations by others who have urged and are urging early action on United Nations reform. However, the Committee has a unique contribution to make to this topic as a result of the depth and detail to which the Committee has analyzed the Programme. Reform is imperative if the United Nations is to regain and retain the measure of respect among the international community that its work requires.

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Broadly, the Committee's conclusions address the adequacy of political oversight and direction, the capacity of the Secretariat to manage the Programme, the United Nations' ability to provide financial oversight and control of the Programme, and the capacity of the disparate bodies within the United Nations system to work effectively and efficiently together in an enterprise of this complexity and size.

The Committee recognizes that the United Nations was faced with an extraordinary challenge for which it was ill-equipped in terms of experience and administrative capacity, and that it faced conflicting political pressures that heightened the management challenges. The Committee also believes that the successes of the Programme, although not extensively chronicled here, should not be buried by the allegations of corruption that have enjoyed so much attention in the media and elsewhere.

That said, the Committee believes: *first*, "professional disciplines" at the United Nations are weak and eroded, and the Secretariat, from its senior levels on down, proved unable to deal effectively with political pressures on its administrative processes; *second*, there appears to be a pervasive culture of responsibility avoidance and resistance to accountability; *third*, there was, at the time, an absence of suitable administrative infrastructure for dealing with the exceptional and sudden demands of this "temporary" operational program; and *fourth*, there was an absence of adequate and independent control and auditing capacity—and little or no desire by the Programme's Executive Director to develop one.

From these conclusions, and others in the same vein, there arise a number of basic questions. To what extent can professional competence, disciplined management, and effective controls be achieved in an Organization deeply influenced by national, and often conflicting, political interests? Should the United Nations (including the Security Council and the Secretariat) strictly limit operational responsibility (to say, peacekeeping) in light of its inherent limited administrative capacity? If so, can others (e.g., United Nations specialized agencies) be delegated to meet operational challenges? With what oversight? If not, how can the administrative capacity of the United Nations be strengthened? Does the Secretary-General have enough authority? Should the role of Deputy Secretary-General be strengthened and made more explicit? Should the Deputy Secretary-General be appointed by the General Assembly on the recommendation of the Security Council, as is the case with the Secretary-General? Should there not be radical change in the hiring and evaluation practices of the personnel system, especially at senior levels?

These questions can be constructively answered only by proceeding with needed and fundamental administrative reforms.

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## II. HISTORY

In the early morning hours of August 2, 1990, Saddam Hussein sent thousands of Iraqi soldiers across the desert to invade and occupy Kuwait. Four days later in New York City, the Security Council responded with a landmark measure—Resolution 661—to prohibit most forms of trade and financial transactions with Iraq. After a multilateral coalition of forces liberated Kuwait in February 1991, the Security Council passed Resolution 687 to continue the sanctions subject to Saddam Hussein’s compliance with conditions for disarmament and his cooperation with international weapons inspections.

Saddam Hussein did not comply, and the broad sanctions regime remained with little effective action to respond to the humanitarian consequences through the first half of the 1990s. Two initial resolutions by the Security Council in 1991 to authorize Iraq to sell oil in return for food and medicine for its people were not accepted by Iraq, ostensibly on the grounds that they infringed its sovereignty. However, it is clear that the Iraqi leadership viewed those efforts as an impediment to its overriding goal of persuading the Security Council that sanctions should be lifted entirely. Thus, the Iraqi leadership feared that agreement to a relief program would take the pressure off the Security Council to lift sanctions in their entirety.

What led to success in establishing an oil-for-food program over time? Beyond the worsening economic and humanitarian condition in Iraq, two events interposed. The first took place early in 1995. To counter eroding support for the maintenance of sanctions and an inclination among some Security Council members to significantly reduce them, the United States, with other members of the Security Council, put forward a new resolution for an oil-for-food program that was intended to be more palatable to the Iraqi leadership than the initial oil-for-food resolutions that had been adopted in 1991. This proposal was adopted by the Security Council, becoming Resolution 986—the basic operational template for the Oil-for-Food Programme.

In the summer of 1995, the second significant event occurred—the defection of a high-level Iraqi official, General Hussein Kamel, son-in-law to Saddam Hussein. His disclosures of Iraq’s illicit weapons programs caused the Security Council to defer indefinitely any consideration of modifying or lifting sanctions, and this in turn caused Iraq to reconsider its stance and consider entering into negotiations with the United Nations about implementing the Programme.

Through the autumn of 1995, both Secretary-General Boutros-Ghali and such countries as France and Russia urged Iraq to negotiate pursuant to Resolution 986. Others also put pressure on Iraq to negotiate. The upshot was that the Iraqi leadership eventually changed tack and, by January 1996, agreed to negotiate on the basis of Resolution 986, under the direct aegis of Secretary-General Boutros-Ghali.<sup>8</sup>

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<sup>8</sup> A more detailed account of these negotiations is contained in Chapter 2 of Volume II of this Report.

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#### **A. THE FORMAL NEGOTIATIONS**

On the eve of negotiations in early 1996, the Secretary-General gathered his senior staff, including Hans Corell, the Under-Secretary-General for Legal Affairs, and directed a “flexible” approach with Iraq. Negotiations eventually involved some fifty meetings from February to May 1996. They involved mostly highly technical discussions of the mechanics of the Programme’s operation, before the two sides reached agreement on May 20, 1996 on the terms of a formal memorandum of understanding (the “Iraq-UN MOU”).

Before negotiations began, the Secretary-General instructed his delegation to keep the talks confidential so as to not to provide an opportunity for members of the Security Council to obstruct or “micro-manage” developments.

Throughout negotiations, the United States and the United Kingdom made their respective views well known to both the Secretary-General and Mr. Corell. In addition, the two governments, given access to a draft memorandum of understanding at a late stage in the negotiations, were able to tighten some of the provisions in the draft agreement, including those concerning the in-country monitoring and in-country distribution systems.

Their additions to the draft consistently shifted decision-making and oversight from Baghdad to the Secretary-General or the 661 Committee. Their comments, however, neither altered nor addressed the basic design of the Programme or its inherent flexibility. In accordance with a basic presumption that the export of oil and the import of humanitarian goods under the Programme would be governed by fair market value, the Iraq-UN MOU affirmed that it would fall to Iraq, and not the United Nations, to choose the parties to whom it would sell oil and, except in northern Iraq, the parties from whom Iraq would purchase humanitarian goods.

#### **B. THE BACKCHANNEL DISCUSSIONS AND IRAQ’S PLAN TO PASS MONEY TO SECRETARY-GENERAL BOUTROS-GHALI**

During the early 1990s, two men—Samir Vincent and Tongsun Park—insinuated themselves into the discussions between the United Nations and Iraq that led to the Iraq-UN MOU and implementation of the Oil-for-Food Programme. Samir Vincent, an Iraqi-born American businessman, maintained close ties to members of the Iraqi leadership. Tongsun Park was a Korean lobbyist in the United States who had developed a friendship with Secretary-General Boutros-Ghali. The evidence gathered by the Committee reveals that both men served as a backchannel of communication between Secretary-General Boutros-Ghali and Iraqi officials.

As noted above, after the highly damaging disclosures resulting from the defection of General Hussein Kamel in August 1995, Iraq decided to enter into negotiation with the United Nations for an Oil-for-Food Programme. But with this choice came another decision from the Iraqi leadership: to attempt to pass money to the Secretary-General in order to ensure, in the words of Iraqi Oil Minister Amer Rashid, that the Secretary-General would be “more flexible” and would take steps to “ease the conclusion” of oil-for-food negotiations. In November 1995, before the beginning of negotiations and with the consent and approval of Saddam Hussein, Deputy Prime

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Minister Tariq Aziz instructed Mr. Rashid to enter into an agreement with Samir Vincent to pay Mr. Vincent \$13.5 million or \$15 million, with the understanding that at least part of the money would be paid to the Secretary-General to encourage him to be more favorable to Iraq in connection with the negotiation and implementation of the Programme.

The Committee has determined that during 1996, as the Iraq-UN MOU was signed and the Programme first implemented, well over \$1 million was paid to Mr. Vincent and Mr. Park in three installments. During this time, these individuals continued to act as a valuable backchannel of communication between Secretary-General Boutros-Ghali and Iraqi officials. But the Committee has not found evidence that Secretary-General Boutros-Ghali received or agreed to receive monies from Mr. Park and Mr. Vincent or that he was aware that Iraq was paying money to Mr. Park and Mr. Vincent. The former Secretary-General denies that he was ever offered or received any money from these men or Iraqi officials. However, the Committee has determined that in 1996, during the time that Mr. Park received a series of payments from the Iraqi regime, he worked to garner support for the Secretary-General's reelection campaign, which was strongly opposed by the United States.<sup>9</sup>

Shortly after the departure of Secretary-General Boutros-Ghali, Iraq also sought to secure another high-level contact at the United Nations in 1997. Mr. Park introduced his Iraqi contacts to a Canadian, Maurice Strong—Secretary-General Annan's newly-appointed Executive Coordinator for United Nations Reform. Mr. Park had been talking to Mr. Strong about purchasing \$1 million in shares of Cordex Petroleum, a company controlled by the Strong family, from a third party. Mr. Park, through his continuing relationship with Iraqi officials, obtained \$1 million in cash, which he immediately used to consummate his stock purchase.

Mr. Strong has indicated that he had no relationship to the Government of Iraq and has emphasized that he declined invitations to visit Iraq. While there is an indication that Iraqi officials tried to establish a relationship with Mr. Strong, the Committee has found no evidence that Mr. Strong was involved in Iraqi affairs or matters relating to the Programme or took any actions at the request of Iraqi officials.<sup>10</sup>

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<sup>9</sup> Further discussion on this matter can be found in Chapter 2 of Volume II.

<sup>10</sup> Further discussion on this matter, including an analysis of the payment for Cordex stock, can be found in Chapter 2 of Volume II.

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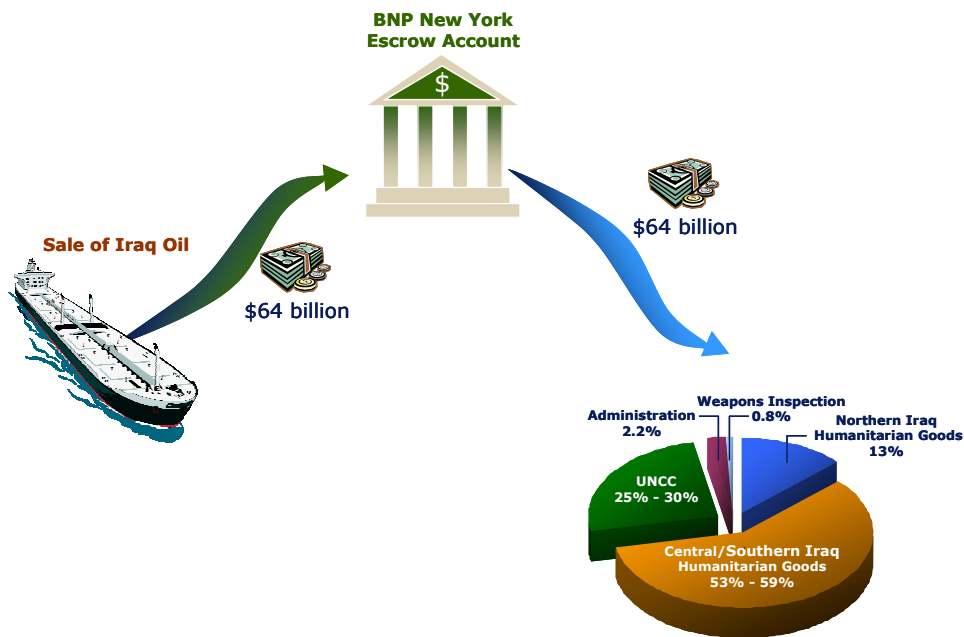
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### III. THE PROGRAMME FRAMEWORK

Resolution 986 did not authorize Saddam Hussein to receive money directly from oil sales. Instead, it directed the Secretary-General to establish an escrow account to receive the oil sales proceeds. In accordance with a distribution plan to be proposed by Iraq and approved by the Secretary-General, approximately two-thirds of the money in the escrow account could be used to buy medicine, health supplies, foodstuffs, and essential civilian needs for the Iraqi people: fifty-three percent for the population in southern and central Iraq and thirteen percent for northern Iraq. The remainder was devoted to the United Nations Compensation Commission (“UNCC”) to pay victims of the war with Kuwait, to pay the costs of weapons inspections, and to defray other administrative and assistance costs, including 2.2 percent allocated to cover the costs of the United Nations for its administration of the Programme.

**Chart A – Planned Distribution of Oil Proceeds<sup>11</sup>**



<sup>11</sup> This chart depicts planned distribution of proceeds only. Not all proceeds ultimately were expended from each of the funds to which they were devoted. The Committee addressed related expenditure issues in its first Briefing Paper. See Independent Inquiry Committee, “Briefing Paper” (Oct. 21, 2004) (hereinafter “Initial Briefing Paper”), pp. 4-8. Nor does the above chart reflect income on proceeds held in the escrow account from interest and currency exchange gains. Numbers may not add to one hundred percent because of rounding.

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Although described in Resolution 986 as “a temporary measure” for the Iraqi people, the Programme endured for seven years through to the fall of Saddam Hussein’s government in 2003. Later resolutions of the Security Council repeatedly re-authorized the Programme in approximate half-year “phases” (each 180 days), resulting in a total of thirteen phases by the Programme’s end.

Oil was first lifted under the Programme in December 1996, and the first shipment of humanitarian goods arrived in Iraq in March 1997. Initially, Iraq could export only \$2 billion of oil per 180-day phase. Beginning in February 1998, the Security Council more than doubled the amount, to allow Iraq to sell up to \$5.256 billion of oil per phase. Then, with the passage of Resolution 1284 in December 1999, the Security Council removed any limitation on the amount of oil that Iraq could sell under the Programme.

As the Security Council authorized more oil sales, Iraq imported a wider range of humanitarian goods under the Programme. In early 1998, the Secretary-General’s review of the Programme noted that “the deterioration of basic infrastructure in other sectors [was] undermining the value of humanitarian inputs.” Consequently, in May 1998, the “Enhanced Distribution Plan,” extended the Programme to include infrastructural support. Throughout the Programme, the United Nations continued adding “sectors,” such as resettlement, settlement rehabilitation, demining, and housing. In 2002, the United Nations approved the addition of ten new sectors, including construction, the Board of Youth and Sports, culture, religious affairs, and justice. By 2003, after seven years of the Programme, the United Nations had enhanced the Programme’s scope to twenty-four sectors, far beyond the basics of food and medicine ordinarily associated with a humanitarian relief operation.

At the outset of the Programme, the United Nations declined Iraq’s request to use proceeds from the Programme for the purchase of parts and equipment to maintain its oil industry infrastructure. But, in June 1998, the Security Council decided to authorize a limited “oil spare parts” program to allow Iraq to import up to \$300 million of parts and equipment for the maintenance and improvement of its oil production and transport facilities. In March 2000, the Security Council doubled the “oil spare parts” exemption to \$600 million per phase.

From 1996 to 2003, Iraq sold more than \$64 billion of oil under the Programme to 248 companies. Of these proceeds, approximately \$32 billion was spent for southern and central Iraq, and nearly \$5 billion was spent for northern Iraq. These funds purchased supplies from approximately 4,510 companies. After the fall of Saddam Hussein’s regime, the Security Council terminated the economic sanctions against Iraq on May 22, 2003, and it directed the phase-out of the Programme’s ongoing operations by November 2003.

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## IV. THE KEY ACTORS

The Programme required complex coordination efforts among three sets of institutions within the overall United Nations organizational framework:

- The Security Council and its 661 Committee;
- The United Nations Secretariat (including the Secretary-General and the Office of the Iraq Programme); and
- Nine United Nations humanitarian agencies.

### A. THE SECURITY COUNCIL AND ITS 661 COMMITTEE

The fifteen-member United Nations Security Council has five permanent members—China, France, Russia, the United Kingdom, and the United States—known collectively as “the P-5.” The remaining ten member countries are elected by the General Assembly to serve two-year terms.

The Security Council has authority under the United Nations Charter to impose economic sanctions—a “complete or partial interruption of economic relations”—where necessary to “maintain or restore international peace and security.” The member states of the United Nations are bound to “accept and carry out the decisions of the Security Council” as provided under the United Nations Charter.

With the passage of Resolution 661 imposing comprehensive sanctions against Iraq, the Security Council created a special sanctions committee—the “661 Committee”—comprised of all fifteen Council members, in order to conduct ongoing oversight of the sanctions regime. Over time, the 661 Committee was entrusted with “monitoring the implementation of the sanctions regime in all its aspects,” in conjunction with “the cooperation of Member States and international organizations.”

For the first several years of the 661 Committee’s existence—*before* the creation of the Programme—its principal role was to address various notifications and requests for exceptions from the sanctions regime (e.g., donations of foodstuffs or other humanitarian goods). The 661 Committee was also charged with examining requests, under Article 50 of the United Nations Charter, for assistance by states adversely affected by the sanctions regime. Travel by airplane to Iraq also was ordinarily subject to notification to the 661 Committee. Finally, the 661 Committee was charged with reporting to the Security Council every ninety days on any reports it received from member states of sanctions violations involving the illegal trafficking of arms.

The advent of the Programme fundamentally altered the 661 Committee’s responsibilities. The Security Council assigned to the 661 Committee a central and virtually unprecedented operational role in the review and approval of billions of dollars of transactions that eventually would be conducted under the Programme. For oil sales transactions, the 661 Committee was in charge of



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reviewing and approving a monthly pricing mechanism and, in some cases, with reviewing and approving individual oil contracts. The 661 Committee's rules provided for the assistance of four oil overseers—"independent experts in international oil trade"—in these duties. In addition, "independent inspection agents" in Iraq were to monitor oil exports on-site and report weekly to the 661 Committee through the oil overseers in New York.

For transactions of goods entering Iraq, during the first three years of the Programme (from 1997 to 1999), the 661 Committee was charged with reviewing all contracts and determining which ones were consistent with the relevant resolutions and therefore could be approved. Before the 661 Committee acted upon a contract, OIP was responsible in the first instance for reviewing each contract for the details of price and value and for determining if the goods identified in the contract were on the approved distribution plan. Several years into the Programme, the Security Council streamlined the approval procedures for goods contracts, progressively shifting approval responsibilities for certain kinds of goods from the 661 Committee to OIP. The 661 Committee remained responsible for reviewing for approval all contracts containing potential "dual use" goods (i.e., civilian goods with potential military use).

The 661 Committee conducted two types of meetings: formal and informal. Formal meetings were recorded on audiotape and in the form of written minutes composed by the Secretariat and circulated to all members of the 661 Committee. By contrast, informal or "experts" meetings were not recorded in any regular fashion; what is known about these meetings can be determined only from individual notes of persons present at these meetings as well as from interviews of those with knowledge of what transpired. Predictably enough, the give-and-take among 661 Committee members at informal meetings was more open than at formal meetings. The 661 Committee conducted more than one hundred formal meetings during the Programme, and many more informal meetings.

The proceedings of the 661 Committee are best understood in light of three procedural realities that materially influenced the manner in which it chose to resolve—or *not* to resolve—issues that came before it:

- The 661 Committee's *consensus rule of decision-making*;
- The *absence of genuine executive authority* for the 661 Committee's chairman; and
- The *domination by the P-5 countries* of the 661 Committee's affairs.

Very soon after its creation in August 1990, the 661 Committee decided that it would make decisions only by means of unanimous consent among all fifteen of its members. The Committee's minutes do not make clear why it settled on a blanket consensus requirement.

The 661 Committee was chaired by the permanent representative (ambassador) of a member country of the Security Council, excluding the five permanent members. In practice, the chair usually came from a western European country and normally served for two years. Given the inherent risk of controversy, it was not a widely sought-after appointment. The remaining representatives to the 661 Committee ordinarily were more junior diplomats from the remaining

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Security Council countries. Given its important operational responsibilities under the Programme, the 661 Committee's make-up of local diplomats, most with little experience in overseeing complex projects of this nature, diminished its effectiveness as a major building block of the Programme's overall governance.

Despite the title and ambassador-level rank, chairmen of the 661 Committee wielded little real authority. One chairman of the 661 Committee lamented his "most miserable" role because of the degree to which the 661 Committee was "polarized" and "dominated" by the P-5 who were most active and carried the bulk of the debate. This imbalance resulted in part from the more powerful position of P-5 members within the Security Council, coupled with the fact that the P-5 members—because of their permanency—had longer institutional memories and records of participation in the affairs of the 661 Committee. Perhaps as important, they had a more sustained interest in the issue.

661 Committee Chairmen often have wry memories of their tenure. As one chairman remarked about his power as chairman: "I could say yes to consensus" among the P-5 countries. Another chairman asserted that the Secretariat of the United Nations was also an "instrument" of the P-5 and that the full 661 Committee was sometimes sidelined by the P-5 countries acting with the Secretariat.

Perhaps the most significant aspect of the 661 Committee's rules and procedures was what they did *not* require. Although established as a monitoring body, the 661 Committee's rules did not require it to take action of any kind in response to a report of a violation of the sanctions regime or a violation of the Programme. With the exception of information indicating illegal arms trafficking, the 661 Committee rules were silent on any obligation to inquire or investigate—much less to report or redress—evidence of illegal activity undermining the sanctions and the Programme. An effort by one ambassador who briefly served as President of the Security Council to make the 661 Committee more responsive to such violations went nowhere.

As discussed in the analytic Volumes that follow this Report, all these themes—the consensus rule, the lack of chairmanship authority, the preeminence of the P-5 countries, and the lack of requirement for action in response to allegations of violations—recurred throughout the Programme as the 661 Committee faced continuing challenges from Iraq's effort to manipulate transactions for its political and economic gain.

## **B. THE SECRETARY-GENERAL, THE SECRETARIAT, AND THE OFFICE OF THE IRAQ PROGRAMME**

The United Nations Charter provides that the Secretary-General acts as the "chief administrative officer of the Organization." The Secretary-General, in turn, is a member of the "Secretariat," which comprises, to quote the Charter, "such staff as the Organization may require."

Although the 661 Committee retained a central role in the review and approval of transactions occurring under the Programme, the Secretary-General and the Secretariat were assigned significant administrative responsibilities for the Programme—these included: (1) the selection of

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a bank to manage the escrow account (along with accountants to audit the account); (2) the appointment of inspection companies to monitor oil exported from Iraq and goods entering Iraq under the Programme; (3) the review and approval of Iraq's distribution plan for goods imported under the Programme; (4) the preliminary review of goods contracts submitted for the 661 Committee's approval and, in the later years of the Programme, with the authority to approve a wide range of goods contracts; (5) the in-country observation and monitoring of goods that entered Iraq under the Programme; and (6) reporting to the Security Council through 90 and 180-day report requirements.

Dr. Boutros Boutros-Ghali was Secretary-General when the Security Council passed Resolution 986 in April 1995 and when the United Nations entered into the memorandum of understanding with Iraq in May 1996. In June 1996, he selected a French bank—Banque Nationale de Paris (“BNP”)—to manage and administer the escrow account. This was followed in July 1996 by the selection of a Dutch company—Saybolt Eastern Hemisphere BV (“Saybolt”)—to inspect and monitor oil exports from Iraq, and then the selection in August 1996 of a British firm—Lloyd's Register Inspection Ltd. (“Lloyd's”)—to inspect and monitor the humanitarian goods that would enter Iraq under the Programme. The politicized manner in which these three contractors were selected contrary to the United Nations' own rules and regulations, was a subject of the Committee's First Interim Report.<sup>12</sup>

Secretary-General Boutros-Ghali's term expired at the end of 1996, just as the first oil sales transactions took place under the Programme. Because of opposition, chiefly from the United States, he was not re-appointed to a second term. His successor, Kofi Annan, was appointed to serve as the seventh Secretary-General of the United Nations beginning in January 1997.

When Secretary-General Annan inherited the Programme, it was run jointly by two different departments of the Secretariat: the Department of Political Affairs (“DPA”) and the Department of Humanitarian Affairs (“DHA”). Ten months later, in October 1997, the Secretary-General decided to create OIP, thereby consolidating the Secretariat's coordination of Iraq-related activities into a single organizational entity. OIP assumed administration of *both* the Secretariat's roles for administration of sanctions under Resolution 661 and for administration of the Programme under Resolution 986.

The Secretary-General appointed Benon Sevan to the position of Executive Director of OIP, and he served in that position until the end of the Programme in 2003. Mr. Sevan had a reputation in United Nations circles as a troubleshooter who had operated effectively in difficult assignments, such as Afghanistan. He also had extensive experience in a variety of fields during a long career within the Organization. As the Committee concluded in its First and Third Interim Reports, Mr.

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<sup>12</sup> Independent Inquiry Committee, “Interim Report” (Feb. 3, 2005) (hereinafter “First Interim Report”), pp. 63-120.

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Sevan compromised his position by secretly soliciting and financially benefiting from Iraqi oil allocations during the course of the Programme.<sup>13</sup>

In March 1998, the Secretary-General appointed Louise Fréchette to the newly created position of Deputy Secretary-General. Mr. Sevan reported directly to Ms. Fréchette, who in turn reported to the Secretary-General. However, these reporting lines rapidly became blurred. Mr. Sevan dealt with both the Secretary-General and the Deputy Secretary-General directly and, on occasion, used the Secretary-General's Chef de Cabinet, S. Iqbal Riza, to facilitate decisions for which Mr. Riza, acting as the Secretary-General's alter ego, had authority.

From its inception in October 1997 through to the termination of the Programme in November 2003, OIP's basic structure remained the same and consisted of the Contracts Processing and Monitoring Division ("CPMD") and the Programme Management Division ("PMD") in New York, plus the Office of the Humanitarian Coordinator ("UNOHCI") located in Iraq.

Just as the oil overseers conducted a review of proposed oil contracts under the Programme, CPMD performed a similar function for humanitarian contracts under the Programme. This included a review to ensure that contracts contained the required information for the 661 Committee to determine whether to approve the contracts and that goods selected for purchase by the Government of Iraq were consistent with the overall objectives of the Programme and an approved distribution plan. Within CPMD, a group of customs experts reviewed contracts, interfaced with mission representatives on matters pertaining to suppliers from their respective countries, and prepared customs reports for review by members of the 661 Committee.

PMD, in theory, provided policy and management advice to OIP's Executive Director in New York, and also consulted with UNOHCI officials to gain an understanding of the Programme's field operations in Iraq.

UNOHCI administered the Programme's field operations in Iraq and was run by a Humanitarian Coordinator in Baghdad and Deputy Humanitarian Coordinators stationed in Baghdad and in Erbil in northern Iraq. UNOHCI's key functions included implementing observation and reporting mechanisms and ensuring the efficient and equitable distribution of supplies to Iraq. UNOHCI was also responsible for overseeing the implementation of the Programme in northern Iraq by the Agencies.

Apart from OIP, the administration of the Programme also drew on services from several other offices within the Secretariat, including for accounting, legal, payroll, treasury, and internal audit functions. More than fifty administrative posts in various units of the Secretariat outside OIP were funded from the Programme's administrative account.

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<sup>13</sup> Ibid., pp. 121-64; Independent Inquiry Committee, "Third Interim Report" (Aug. 8, 2005) (hereinafter "Third Interim Report"), pp. 5-52.

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**C. THE UN-RELATED AGENCIES**

While the Saddam Hussein government administered and distributed humanitarian goods in southern and central Iraq, because of its mistreatment of and animosity towards the Kurds in northern Iraq and the semi-autonomous status of that region, a separate administration, procurement, and distribution system existed for goods furnished to the northern governorates of Dohuk, Erbil, and Suleimaniyah. This system was administered in the name of the United Nations Inter-Agency Humanitarian Programme (“UNIAHP”) and involved nine United Nations entities (hereinafter referred to as “the UN-related Agencies” or “the Agencies”).<sup>14</sup> In addition to their administrative responsibilities in northern Iraq, the Agencies were tasked with observing the equitable distribution of humanitarian supplies throughout the entirety of Iraq.

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<sup>14</sup> Food and Agricultural Organization (“FAO”); International Telecommunication Union (“ITU”); United Nations Development Programme (“UNDP”); United Nations Educational, Scientific and Cultural Organization (“UNESCO”); United Nations Human Settlements Programme (“UN-Habitat”); United Nations Children’s Fund (“UNICEF”); United Nations Office for Project Services (“UNOPS”); World Food Programme (“WFP”); and World Health Organization (“WHO”).

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**V. APPROVAL OF CONTRACTS UNDER THE PROGRAMME**

In light of Iraq's agreement to participate in the Programme, the 661 Committee approved internal rules to govern the 661 Committee's review of oil and humanitarian contracts under the Programme. The operation of these rules is significant to an understanding of the manner in which Iraq eventually was able to subvert the Programme by means of soliciting payments from companies outside of the United Nations escrow account.

**A. OIL SALES**

A company that wished to buy oil could negotiate and enter into a contract with Iraq's State Oil Marketing Organization ("SOMO"). The company then sought approval of the contract from the United Nations. In the ordinary course, the company had to register or already be registered with the United Nations through the diplomatic mission of its home country. This registration allowed the company to deal directly with and secure approval of its contract from expert oil overseers who worked at the United Nations and who advised the 661 Committee. The overseers' job was to negotiate on a monthly basis a fair market oil pricing formula with SOMO. The overseers then submitted their recommendation for approval of the monthly pricing mechanism to the 661 Committee.<sup>15</sup>

Once the 661 Committee approved the pricing mechanism, two or more overseers could approve jointly any particular contract between a company and SOMO, if the contract terms included the approved pricing mechanism, the details of a confirmed irrevocable letter of credit, and a quantity of oil that would not result in exceeding the overall dollar limitations authorized under the Programme.

Once a contract was approved, the oil was loaded (i.e., "lifted") by seagoing oil tankers from one of two approved oil port terminals: the port of Ceyhan in Turkey (the terminal point for the Kirkuk-Yumurtalik pipeline from Iraq to Turkey) or Mina al-Bakr (an offshore loading platform in the Persian Gulf). Each transfer of oil from Ceyhan or Mina al-Bakr was subject to on-site monitoring by Saybolt's inspectors. A company purchasing oil under the Programme was required to pay the full amount of the contract price by means of a letter of credit from its bank in favor of the escrow account maintained by BNP.

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<sup>15</sup> As discussed below, beginning in October 2001, the United States and the United Kingdom altered the approval process with the adoption of a "retroactive pricing" policy that was designed to restrict Iraq's ability to profit from illegal oil surcharges.

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**B. GOODS PURCHASES**

A company that wished to sell humanitarian or other civilian goods under the Programme contracted with a domestic ministry or state agency of the Government of Iraq or, for most goods intended to be distributed in northern Iraq, with one of the UN-related Agencies (discussed above). The goods were required to have been identified in advance on a distribution plan that the Secretary-General approved for each phase. The contract was forwarded through the company's home country mission to CPMD at the United Nations, where it was subject to review for the details of pricing and value. If the contract's paperwork was in order, the contract was then subject to the 661 Committee's review and approval under a "no objection" procedure (i.e., the contract was deemed approved if no member of the 661 Committee lodged an objection within a prescribed time period). As noted above, in later years of the Programme, OIP was authorized to review and approve a range of contracts involving goods without dual-use potential.

Upon approval of a goods contract, the goods could be transported into Iraq. The goods were required to be certified for entry by Lloyd's (and by Cotecna beginning in January 1999) at one of four border inspection points: (1) Zakho on the border of Turkey; (2) Trebil on the border of Jordan; (3) Al-Waleed on the border of Syria; or (4) the port of Umm Qasr on the Persian Gulf. Once entry was approved, BNP could make payment to the supplier of the goods from the escrow account.

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## VI. THE SCHEMES TO DERIVE ILLICIT INCOME AND RESPONSE OF THE SECURITY COUNCIL

It was a basic but flawed assumption of the Programme that Iraq—not the United Nations—would choose, and negotiate with, the parties to whom it would sell oil and, except in northern Iraq, the parties from whom Iraq would purchase humanitarian and oil-spare-parts goods. The United Nations may have been right to acknowledge that “[t]he most efficient way of selecting Iraqi petroleum and petroleum products is for Iraq to carry out the marketing . . . in conformity with its normal trading practices” and that “[i]t would be highly unusual if the United Nations were to engage in trading Iraqi oil directly or through a third party.”<sup>16</sup> However, the decision to allow Iraq to choose its contracting partners empowered Iraq with undue economic leverage to advance its broader interests in overturning the sanctions regime and obtaining illicit funds.

According to numerous Iraqi witnesses interviewed by the Committee, Iraq decided early in the Programme to give contract preferences to companies from countries that it perceived as sympathetic to the lifting of sanctions, including most prominently some members of the Security Council. Companies from Russia, France, and China—all permanent members of the Security Council that were more sympathetic to Iraq’s wish for an end to sanctions than the United Kingdom and the United States—were accorded highly favored access to Iraq’s business under the Programme.

At first glance, companies from Russia far outdistanced companies from either France or China in the small cluster of nations whose companies were purchasing oil from Iraq. Others in the P-5 lagged significantly behind the three front-runners. In fact, with respect to the United States, with one exception (for a company controlled by Samir Vincent), Iraq blacklisted United States oil companies after Phase III of the Programme ended in May 1998. Nevertheless, although Iraq chose not to sell directly to United States companies, approximately thirty-six percent of Iraq’s oil ultimately was shipped to the United States.

According to Iraqi officials, a similar pattern of preference prevailed for Iraq’s choice of suppliers for humanitarian and oil-spare-parts goods, with Russia and France clustered at the top. Russian officials maintain that a sizeable number of supplier companies were in fact front or shell companies using Russia as a convenient home country.

For humanitarian and oil-spare-parts goods, Iraq’s top officials frequently instructed its civilian ministries to procure goods on behalf of government organs that could not participate legitimately in the Programme, such as the Ministry of Military Industrialization, the Ministry of Defense, and the *Mukhabarat*, or Intelligence Services. The most common purchaser of “diverted” goods was

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<sup>16</sup> “Report by the Secretary-General Pursuant to Paragraph 5 of the Security Council resolution 706 (1991),” S/23006, paras. 20-21 (Sept. 4, 1991).



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the Ministry of Agriculture, but many other ministries, including the Ministries of Transportation and Electricity, also played a part in diverting goods. The most common class of diverted goods was automobiles, especially trucks.

In addition to directing oil contracts in favor of certain countries, Iraq's Ministry of Oil also pursued a policy beginning in 1998 of furnishing "allocations" of oil to certain individuals that it believed could assist its effort to lift the sanctions regime. This group of beneficiaries prominently included Benon Sevan—the principal United Nations official charged with the Programme's oversight—as well as present and former politicians and diplomats, members of organizations supportive of Iraq, relatives of influential families in the Middle East, lobbyists, and media figures. The individual allocation recipients, in turn, would designate a company to enter into the contract for oil with SOMO and receive a commission from the company for the rights to the allocation.

## A. MANIPULATION OF PROGRAMME TRANSACTIONS

As indicated earlier, among the most potent challenges to the Programme's integrity were Iraq's often successful efforts to manipulate transactions with companies in order to extract funds that otherwise would flow to the escrow account.

### 1. Oil Surcharges

In approximately August 2000, Iraq started requesting its oil customers to pay a surcharge of ten cents per barrel—separate from their required payments to the escrow account. Because the request was made in the middle of a Programme phase, many buyers chose not to comply. In early November 2000, Iraq proposed to the Secretary-General to include a payment of 1.5 euros per barrel to meet Iraq's costs to operate its oil production and distribution facilities and for this to "be remitted to a special account designated by SOMO." The Secretary-General passed this request on to the Security Council, which declined to act on it favorably for Iraq.

In the face of this rejection and the refusal by some oil buyers to pay the ten-cent surcharge, Iraq decided by the end of November 2000 to require the buyers' payment of a surcharge and also to raise the surcharge to fifty cents per barrel—all without notice to or approval of the United Nations. In order to allow oil buyers a sufficient margin from which to pay the surcharge, SOMO proposed below-market prices for the upcoming month of December 2000 to the United Nations oil overseers. The oil overseers and 661 Committee declined to agree to these low prices, and this led to a shutdown of Iraq's oil trade for the first twelve days of December 2000. When exports resumed, far fewer companies elected to lift oil because of the instability and general reluctance to accede to Iraq's surcharge demand. Total exports plummeted, and it cost the Programme more than \$2 billion in expected revenues from December 2000 through February 2001.

This imposition of surcharges was widely reported in the media and confirmed to the 661 Committee by its overseers based on the overseers' industry contacts. The 661 Committee agreed to have the oil overseers send a warning to oil buyers, but it could not agree on any other remedial

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steps. Russia—the country with the largest number of oil buyers under the Programme—asserted that there was a lack of evidence that Iraq actually was imposing surcharges. As a result, the 661 Committee could not reach consensus on a United States proposal that would have restricted the group of oil buyers to established and creditworthy companies.

Iraq decided in January 2001 to lower its surcharge demands to between twenty-five and thirty cents per barrel, and oil exports steadily rose again to near pre-surcharge levels at the end of the Programme's ninth phase in June 2001. The return to stability was accomplished in part by a small group of companies that were willing to go along with the surcharge scheme, but to do so by using various shell companies to mask their involvement with these illegal payments. The United Nations oil overseers warned the Security Council that “practically all” Iraqi oil was sold to “contract holders” that “do not get involved in shipping, financing or other risk bearing activity,” and that “[t]his is rather unprecedented in the oil industry and only exists in this shape and form in the case of Iraq.” The Security Council took no action on the basis of this information.

The Security Council declined to act on draft resolutions sponsored by the United Kingdom and France to tighten buyer registration requirements. Nor would the 661 Committee or Security Council agree to other pricing reform proposals designed to reduce the potential for middlemen buyers to earn large profits from which surcharges could be paid. The Security Council was briefed by the oil overseers on the dominant role of middlemen buyers, and the unprecedented gap between what end-users were paying for Iraqi oil and what the middlemen buyers were paying for oil under the Programme.

In October 2001, the United Kingdom and the United States—acting over the objections of China and Russia—imposed “retroactive pricing.” This entailed withholding approval of the pricing mechanism until after the oil had been lifted—when it could be determined what the true fair market value of the oil was at the time of actual lifting. Retroactive pricing made it less profitable for buyers to pay surcharges, and Iraq's gains from surcharges decreased as fewer companies chose to lift oil.

In September 2002, Iraq decided to terminate the surcharge policy in the midst of continued lower oil sales. Ultimately, apart from the imposition of retroactive pricing by the United Kingdom and the United States, the 661 Committee did not redress Iraq's illegal surcharge policy.

Most of the surcharge payments were sent by wire to Iraqi-controlled accounts at banks in Jordan and Lebanon, often for concealment purposes to accounts established in the names of SOMO officials or other Iraqi individuals. Money from these accounts went to Baghdad. Apart from these bank wire payments, according to payment records and receipts produced to the Committee by SOMO, nearly one-third of the surcharge payments were made by cash delivery to various Iraqi embassies abroad, including in Egypt, Greece, Italy, Malaysia, Russia, Switzerland, Syria,

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Turkey, and Vietnam. By far the largest number of payments was from Russian companies (including several Russian state-owned companies) to Iraq's embassy in Moscow—more than \$52 million from March 2001 to December 2002.<sup>17</sup>

## 2. Kickbacks – After-Sales-Service Fees and Inland Transport Costs

In August 2000, Iraqi ministries were ordered to collect kickbacks on all contracts signed by suppliers of humanitarian and oil-spares-part goods to Iraq. Typically, these kickbacks were styled as “after-sales-service fees,” and this scheme was introduced ostensibly to cover internal expenses incurred by the Government of Iraq in administering the Programme, but the Committee has not been able to verify that the funds derived were spent in such a manner. Regardless of the use to which these payments were put, they were payments directly to Iraq and outside the Programme's authorized escrow account.

By late 2000, prospective vendors of goods to Iraq generally would not see their bids approved by the ministries without agreeing to pay an after-sales-service fee of at least ten percent of the contract value. Once the vendor agreed to pay the kickback, the contract price would be inflated by a set percentage and submitted to the United Nations for approval. In this way, vendors could pay the kickback without affecting their anticipated margins of profit. From the perspective of Iraqi officials, the kickback scheme was a means of reclaiming money held in the escrow account, which they viewed as the legitimate property of the Government of Iraq.

In addition to this formal kickback scheme, a parallel means of collecting illegal revenues began as early as June 1999 and expanded significantly in summer 2000. This mechanism involved the imposition of fees for the transportation of those commodities imported at Iraq's port at Umm Qasr to inland destinations such as Baghdad inside Iraq. These inland transportation fees, which in practice should have been borne by the Government of Iraq rather than the contractor, were incorporated into contract values, but paid outside the authorized escrow account to companies or bank accounts controlled by the Iraqi regime.

The 661 Committee devoted even less attention to kickbacks on humanitarian contracts than it did to oil surcharges—yet these kickbacks eventually turned out to be a far greater source of illicit revenue for Iraq than oil surcharges. Company complaints and media reports of demands for kickbacks surfaced as early as 1997, and, in November 1999, the United States and the United Kingdom publicly expressed concerns about the Iraqi regime's exploitation of the Programme to obtain payments from goods suppliers outside the escrow account. However, it was not until the first half of 2001 that the 661 Committee addressed humanitarian kickbacks; even then, discussion was limited to a few meetings. No action was taken.

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<sup>17</sup> For details on the mechanics of these transactions, see Chapter 1 of Volume II of this Report.

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In March 2001, the United States introduced a proposal with steps that could be taken to curtail kickbacks, but the 661 Committee never seriously considered the merits of these or any other proposals to redress the payment of kickbacks. The following month, the United Kingdom sent a letter to OIP identifying fifteen humanitarian contract applications with payment and service clauses that might mask kickbacks, but all except one of these applications were approved. In 2001 and 2002, OIP submitted to the 661 Committee at least seventy customs reports that identified pricing concerns, but it appears that 661 Committee members placed a pricing-related hold on only one of these applications. This was during a period when all contracts were subject to kickbacks.

The kickback schemes remained in place for the duration of the Programme until after the military invasion of Iraq by coalition forces in the spring of 2003.

In the end, there was no sustained effort by the Security Council and its 661 Committee to investigate allegations of humanitarian contract kickbacks or to take remedial steps to curb Iraq's ability to derive illegal income outside the sanctions regime.

The final report of the Committee in October 2005 will present comprehensive data with respect to purchases of oil and sales of goods to Iraq, including evidence concerning Iraq's grant of allocations to particular individuals. That report will also address the operation of the surcharge and kickback schemes in more detail and, in particular, the degree to which particular companies and individuals were complicit in making illegal payments outside the Programme.

## B. SMUGGLING

It is now well known that the Iraqi regime of Saddam Hussein derived far more revenues from smuggling oil *outside* the Programme than from its demands for surcharges and kickbacks from companies that contracted *within* the Programme.<sup>18</sup> Thousands of vessels, vehicles, and trucks carried smuggled oil and goods—in both directions across the Iraqi border—without any kind of inspection or oversight by the United Nations. By the Programme's design, inspectors were charged only with the inspection of oil and goods that were financed under the Programme. They had no directions or mandate to inspect or report on cargo smuggled in violation of United Nations sanctions outside the Programme. This was true despite the fact that the 661 Committee had responsibilities for the oversight of sanctions observance as well as oversight of the Programme.

Because smuggling occurred outside the Programme, it has not constituted a major focus of the Committee's work. But smuggling cannot be completely excluded from the purview of the

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<sup>18</sup> See "First Interim Report," pp. 41-42 (summarizing smuggling estimates compiled by the United States Senate Permanent Subcommittee on Investigations, the United States General Accountability Office, the United States Iraq Survey Group, and the Coalition for International Justice).

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Committee because—in the words of one United States ambassador—“[s]muggling steals money from the oil-for-food programme and puts it to illicit purposes.” At least as important, turning a blind eye to smuggling surely undercut a sense of discipline in conducting the Programme generally. Accordingly, to the extent that smuggling was known by the responsible authorities, and it was, it posed a vital management and political question, to wit: what steps could—and should—have been taken to stop the smuggling or “capture” the smuggling revenues for the Programme in order to advance the Programme’s humanitarian goals and to restrict these funds from being used for the corrupt and potentially lethal purposes of Saddam Hussein?

Here the spotlight is on the role of the Security Council—including its 661 Committee—as it was the body that possessed primary authority to determine the scope of the Programme and the degree to which it would acquiesce to a parallel universe of trade outside the Programme. For all these reasons, it is important to know: (1) What smuggling occurred during the course of the Programme?; (2) What did the Security Council and member states know about this smuggling activity?; and (3) What did the Security Council and member states do in response to smuggling activity?

## 1. The Neighborhood

Consideration should be given first to Iraq’s smuggling trade with three of its neighbors who faced a disproportionate burden from sanctions—Jordan, Turkey, and Syria—and Iraq’s smuggling of oil by sea through the Persian Gulf. The names of the countries and the means of smuggling may vary, but several common themes emerge:

- The awareness of the Security Council of large and increasing amounts of border trade activity outside the Programme;
- The constraints of the consensus rule of decision-making in the 661 Committee, diminishing the effectiveness of the Security Council and the 661 Committee in their responses to reports of illegal smuggling activity;
- The primacy of political preference over evenhanded enforcement of sanctions against Iraq and its neighboring countries—as most prominently demonstrated by the United States’ tolerance for trade with Jordan and Turkey (but not Syria), and by Russia’s and France’s reluctance to redress smuggling activity between Iraq and Syria; and
- The degree to which Iraq and its neighbor states ultimately were emboldened by Security Council inaction to increase their illicit trading relationships and to expand their illicit trade for the benefit of Saddam Hussein’s government.

In the case of Jordan, the Security Council declined to act on Jordan’s repeated requests, under Article 50 of the Charter, for official authorization to import oil from Iraq. Instead, the 661 Committee ambiguously “took note” of Jordan’s intent to import Iraq oil. This furnished sufficient cover for Jordan to acquire nearly \$6 billion of oil from Iraq (much of it during the Programme, from 1996 to 2003). There was no genuine effort by the Security Council to monitor

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these transactions or the goods that Jordan in turn shipped back to Iraq. By September 2002, Jordan abandoned a pure barter arrangement, and it started paying cash to Iraq.

In the case of Turkey, the 661 Committee turned a blind eye to widespread reports of oil smuggling through Iraq's Kurdish area and across its northern border. When Turkey sought formal permission in 1996 to trade with Iraq under Article 50, the 661 Committee repeatedly deferred consideration of the request for several years. Then it simply removed the item from its agenda. The illegal and unmonitored border trade continued. A belated effort in 1999 by the Netherlands and the United Kingdom to bring Turkey's trade within the Programme failed for lack of support among other members of the Security Council. Thereafter, Turkey negotiated a formal border trade protocol with Iraq in January 2000, and Iraq ultimately derived more than \$800 million in estimated oil sales proceeds outside the Programme from this illegal trade with Turkey.

In the case of Syria, Iraq long harbored ambitions to reopen and use a pipeline that stretched from Iraq's northern Kirkuk fields to the Mediterranean coast in Syria and that had closed in the early 1980s. To this end, Iraq sought approval at the outset of the Programme, in 1996, to export oil through the Syrian pipeline. But the Security Council allowed only two points for export of Iraqi oil—one through a pipeline into Turkey and one through a pipeline to a loading terminal in the Persian Gulf. So Iraq and Syria later decided to take matters into their own hands. They negotiated a formal border trade protocol in 2000 and then refurbished and reopened the pipeline in November of that year.

The reopening of the pipeline was widely reported in the press and also raised in the 661 Committee, but the 661 Committee dissolved in discord over how to respond. It could not agree even to send a letter of inquiry to Syria about the matter, much less to initiate any true investigation of the matter. In light of the smuggling that already was occurring through Jordan and Turkey, the United Kingdom and the United States sought, in mid-2001, to modify the Programme by establishing new arrangements by which all of Iraq's border trade could be limited and controlled. But this effort failed in the face of opposition from China, France, and Russia, as well as the entrenched interests of the affected border countries, which had long since accustomed themselves to trading freely outside the Programme.

In the meantime, because of the economies of scale afforded by the pipeline, Syria soon became Iraq's largest illegal oil export outlet. Syria joined the Security Council in 2002 and thereby automatically the 661 Committee. It was then easily able—because of the 661 Committee's consensus voting rule—to block any inquiry by the Committee. During the last four years of the Programme, Iraq derived more than \$3 billion of smuggling revenue from Syria.

In the case of smuggling through the Persian Gulf, the naval advantage of the United States and other members of the Maritime Interception Force (the "MIF") allowed the Security Council to

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exercise a greater degree of control over smuggling by sea than over smuggling by land with Jordan, Turkey, and Syria. Smuggling by sea remained a constant occurrence but, over time and with the active diplomatic efforts of 661 Committee chairmen and the cooperation of Iran, the level of smuggling by sea, with one notable exception,<sup>19</sup> was effectively reduced.

## **2. Volume of Oil Available for Protocols and Smuggling**

The first and most obvious question regarding Iraq's smuggling of oil is how much oil was available for smuggling. Iraq engaged in unofficial trade involving oil transactions throughout the sanctions period. The transactions ranged from those based on relatively formalized arrangements, such as the protocols with governments of several countries, to less formalized, smaller scale arrangements, such as selling crude and refined products in smaller lots to private parties.

Between 1991 and 2003, Iraq produced more than 7.3 billion barrels of oil. Some 3 billion barrels were used internally during this period, mainly either as refined products or to produce power. Consequently, nearly 4.3 billion barrels were available for trade. Backing out the 3.4 billion barrels sold through the Programme, nearly 900 million barrels were available for unofficial trade, of which nearly 650 million barrels were available during the Programme period.

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<sup>19</sup> For a discussion of this exception, please see Section II.I in Chapter 4 of Volume II.

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Table 1 - Iraqi Oil Available for Smuggling (in millions of barrels)

Year	Total Production	Internal Consumption	Re-Injection of Crude & Fuel Oil	Oil Sold Under the Programme	Total Oil Available for Smuggling
<i>Prior to the Programme</i>					
1991	191.38	86.61	87.31	-	17.46
1992	385.06	112.00	237.42	-	35.64
1993	370.55	110.19	235.69	-	24.67
1994	377.01	104.54	237.84	-	34.63
1995	387.63	107.68	253.98	-	25.97
1996	420.22	104.37	238.34	-	77.51
<i>Sub-total</i>	<i>2,131.85</i>	<i>625.41</i>	<i>1,290.57</i>	<i>-</i>	<i>215.87</i>
<i>During the Programme</i>					
1997	546.64	115.15	145.59	246.46	39.44
1998	791.58	121.75	70.64	545.75	53.45
1999	927.62	124.25	7.78	728.16	67.43
2000	952.05	132.59	10.71	703.58	105.17
2001	943.76	149.59	23.93	619.61	150.63
2002	812.80	171.34	28.36	461.50	151.59
2003	226.18	17.46	8.50	125.66	74.56
<i>Sub-total</i>	<i>5,200.63</i>	<i>832.13</i>	<i>295.51</i>	<i>3,430.72</i>	<i>642.27</i>
<b>Total</b>	<b>7,332.48</b>	<b>1,457.55</b>	<b>1,586.07</b>	<b>3,430.72</b>	<b>858.14</b>

## C. SOURCES AND AMOUNTS OF ILLICIT INCOME TO IRAQ

Much interest has been expressed, a number of estimates have been set forth, and considerable confusion exists with respect to the illicit earnings of the former Iraq regime from the Programme. Part of the difficulty is that the distinction has been lost between gains from “smuggling”—that is from violations of the sanctions against Iraqi oil exports that began well before the Programme started—and gains from manipulation of sales of oil and purchase of humanitarian goods under the Programme itself.

In gross terms, by far the largest source of illicit income to Iraq during the period of the Programme was from “trade protocols” with its neighbors and from clandestine smuggling with unofficial parties. The trade protocols involved Iraq’s sale of oil in return for goods and for cash. In addition, it is well known that sources of illicit income within the framework of the Programme itself were also substantial. Identifying these latter flows is relevant not only for judging the extent to which the Iraqi regime benefited from manipulating the Programme, but also to provide an index to the degree the United Nations failed to thwart corruption and fraud in administering the Programme.



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Consequently, the Committee has made a concentrated effort, with the cooperation of the Government of Iraq, to make a definitive estimate of the amounts of illicit income involved, largely through oil surcharges and humanitarian kickbacks. Given the amount of empirical data available to it from the extensive investigation, the Committee believes these new estimates are more reliable than the previous estimates made by other investigators and private organizations.

The following table itemizes the sources of Iraq's derivation of illicit income—about \$10.2 billion during the period of the Programme from 1997 to 2003 in the form of surcharges on oil contracts under the Programme, kickbacks on humanitarian contracts under the Programme, and smuggling of oil outside the bounds of the Programme. In the several years prior to the Programme, Iraq derived another \$2.6 billion of revenue from the sale of oil to its neighboring states in contravention of the sanctions regime.

**Table 2 – Illicit Income Received by Iraq Prior to and During the Programme (in USD millions)**

	Revenue Prior to the Programme	Revenue During the Programme
<b><u>Protocol &amp; Private Sales Revenue</u></b>		
<i>Protocol Revenue</i>		
Jordan	\$ 2,599.8	\$ 3,376.6
Egypt		44.8
Turkey		806.7
Syria		3,132.1
Sub-total of Protocol Revenue	2,599.8	7,360.0
<i>Border Trade</i>	-	1,030.4
<b>Total Protocol and Private Sales Revenue</b>	<b>\$ 2,599.8</b>	<b>\$ 8,390.4</b>
<b><u>Programme-Related Revenue</u></b>		
<i>Transaction Fees on Oil Sales</i>		
Surcharges on Oil Sales		\$ 228.8
<i>Transaction Fees on Humanitarian Purchases</i>		
After-Sales-Service Fees		1,055.9
Inland Transportation Fees		527.5
Sub-total of Transaction Fees on Humanitarian Purchases		1,583.4
<b>Total Programme-Related Revenue</b>		<b>\$ 1,812.2</b>
<b>Total Estimated Illicit Income</b>	<b>\$ 2,599.8</b>	<b>\$ 10,202.6</b>

An explanation of the basis for these figures is set forth below.

## 1. Income from Oil Surcharges on Programme Contracts

As described elsewhere, as the Programme proceeded, Iraq moved aggressively to impose and regularize transaction charges on both oil sales and goods imports. The net effect of these

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measures was to provide income to the Iraqi regime free of the constraints imposed by the Programme on the nature of imports.

In the case of oil sales, involving a standard and widely traded commodity, the approach was relatively simple and straightforward: a charge ranging generally from ten cents to fifty cents per barrel over time was exacted from those purchasing oil. For goods imports, arrangements were more complicated. Many of the goods themselves were not freely traded commodities and were not standard in quality. One implication was that pricing decisions agreed upon by Iraq and the supplier were much more difficult to review by United Nations staff. The opportunity for illicit income—through a variety of transaction charges—thus was much greater than through the widely known oil surcharges.

In the case of oil surcharges, detailed Iraqi records show not only the total funds collected, but those responsible for the payments and the method of payment. In sum, approximately \$263 million was levied and expected in surcharge revenue on nearly 400 oil contracts. Actual payments of \$229 million were made by 138 contractors on 309 contracts. This data corresponds to the figures published earlier by the Iraq Survey Group of the United States government. The table below also identifies these payments by avenue of payment, highlighting cash payments through Iraqi embassies.

**Table 3 – Confirmed Deposits of Surcharges (in USD millions)**

	Total	% of Total
Embassies and representative offices of Iraq		
Ankara, Turkey	\$ 1.1	0.5%
Athens, Greece	0.7	0.3%
Cairo, Egypt	0.2	0.1%
Damascus, Syria	1.2	0.5%
Geneva, Switzerland	0.7	0.3%
Hanoi, Vietnam	3.0	1.3%
Kuala Lumpur, Malaysia	0.9	0.4%
Moscow, Russia	52.8	23.1%
Rome, Italy	0.1	0.0%
Sana'a, Yemen	0.5	0.2%
Vienna, Austria	0.1	0.1%
<i>Sum of deposits via embassies and representative offices of Iraq</i>	<i>61.3</i>	<i>26.8%</i>
Jordan National Bank, Jordan	128.8	56.3%
Fransabank, Lebanon	29.8	13.0%
Company records	6.0	2.6%
<b>Surcharges confirmed</b>	<b>225.9</b>	<b>98.7%</b>
Unconfirmed surcharges	2.9	1.3%
<b>Total surcharges paid</b>	<b>\$ 228.8</b>	<b>100.0%</b>

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In the case of humanitarian goods imports, as discussed above, the Iraqi regime derived illicit revenue principally from after-sales-service fees (generally in an amount of at least ten percent of the contract price) and inland transportation fees. Other miscellaneous “tender fees” and less coordinated payments to Iraqi officials are known to have happened. Reliable estimates of the amounts involved are not possible, but are believed to be relatively small in total.

## 2. Income from Kickbacks on Humanitarian Goods Contracts

Information for these humanitarian kickbacks is less complete and precise than that for oil surcharges. However, the Committee’s large information base includes: (1) the actual amount spent on import contracts, (2) the policies put in place by Iraq at particular times, and (3) accounting and banking records from a number, but not all, of the ministries dealing with levying and collecting the fees and charges. The availability of this material data largely explains the differences in the Committee’s estimate from earlier estimates of others. In total, the Committee estimates the former Iraqi regime illicitly obtained approximately \$1.6 billion through exploitation of humanitarian transactions under the Programme.

## 3. Income from Smuggling During the Programme

The estimates presented here of revenue from trade protocols and other smuggling activity is derived directly from comprehensive data recently made available by SOMO. Jordan, Syria, and Turkey have not responded to repeated requests for similar data. However, this data from SOMO have been tested against more limited data available from a variety of other sources, tending to confirm the reliability of the new and more detailed data.

**Table 4 – Oil Sold Outside of the Programme (in USD millions)**

Year	Protocols					Border Trade	Total	Actual Cash Received
	Jordan	Syria	Turkey	Egypt	Total			
	A	B	C	D	E=A+B+C+D	F	G= E+F	
1991	\$ 333.51	\$ -	\$ -	\$ -	\$ 333.51	\$ -	\$ 333.51	\$ 157.51
1992	472.37	-	-	-	472.37	-	472.37	253.37
1993	405.11	-	-	-	405.11	-	405.11	224.11
1994	377.69	-	-	-	377.69	-	377.69	196.69
1995	423.26	-	-	-	423.26	-	423.26	220.26
1996	587.87	-	-	-	587.87	-	587.87	257.87
<b>Sub-total</b>	<b>\$ 2,599.81</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,599.81</b>	<b>\$ -</b>	<b>\$ 2,599.81</b>	<b>\$ 1,309.81</b>
1997	\$ 653.06	\$ -	\$ -	\$ -	\$ 653.06	\$ 11.84	\$ 664.90	\$ 403.06
1998	331.85	-	-	-	331.85	16.70	348.55	82.85
1999	420.20	-	-	-	420.20	236.86	657.06	216.20
2000	687.16	197.30	98.29	-	982.75	396.32	1,379.07	505.40
2001	509.63	1,131.02	281.58	5.74	1,927.97	183.11	2,111.08	776.97
2002	623.35	1,350.01	373.41	39.02	2,385.79	98.68	2,484.47	1,028.31
2003	151.30	453.74	53.37	-	658.41	86.87	745.28	225.85
<b>Sub-total</b>	<b>\$ 3,376.55</b>	<b>\$ 3,132.07</b>	<b>\$ 806.65</b>	<b>\$ 44.76</b>	<b>\$ 7,360.03</b>	<b>\$ 1,030.38</b>	<b>\$ 8,390.41</b>	<b>\$ 3,238.64</b>
<b>Total</b>	<b>\$ 5,976.36</b>	<b>\$ 3,132.07</b>	<b>\$ 806.65</b>	<b>\$ 44.76</b>	<b>\$ 9,959.84</b>	<b>\$ 1,030.38</b>	<b>\$ 10,990.22</b>	<b>\$ 4,548.45</b>

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Most of this smuggling took place within the terms of intergovernmental “trade protocols” with the neighboring states of Iraq. Analysis of those protocols, together with data on the volume of oil sales, makes clear that the pricing of the oil was well below prevailing market prices.

In the early years of the sales to Jordan, the proceeds were used substantially for debt repayment and for the purchase of goods. Because the pricing on both sides was not anchored in market prices, the data must be interpreted with care.

#### **4. Distorted Pricing**

Unlike the transaction costs—surcharges and kickbacks—described above, there was also underpricing of oil exports and overpricing of goods imports. Similarly reliable estimates are not possible with regard to the costs to the Iraqi people resulting from deliberate underpricing of oil exports or overpricing of goods imports. In effect, the government of Saddam Hussein was willing to forego revenue from oil sales or to overpay for imports to reward or encourage certain foreign politicians, journalists, and businesses to exert influence in its favor, most especially in advocating a lifting of the sanctions. There are also allegations that some of these illicit profits found their way to the benefit of individual Iraqi officials, presumably in the form of cash or disguised foreign bank accounts. Generally, the Committee notes that substantially more funds illicitly flowed to the Saddam Hussein regime through its sanctions-busting activities than through bribery on the part of individuals. In any event, the Committee has not found evidence to suggest that individual bribery by Government of Iraq officials was of a magnitude sufficient in itself to materially alter the overall financial picture set out in this Report.

Before the introduction of retroactive pricing, Iraq underpriced oil sold through the Programme relative to market prices by increasing amounts over time. To some degree, some discount from market prices early in the Programme was necessary, and accepted by the oil overseers, to encourage buyers amidst political and market uncertainties inherent in Iraqi trade. Later, there was direct and indirect (from econometric analyses) evidence of buyer discounts. The discounts increased particularly at the time the surcharges were introduced and established commercial buyers backed out of the market. At least in part, the discounts from market prices provided large profit opportunities to trading companies, some of which were clearly acting on behalf of persons or entities that Iraq wished to benefit, which is discussed elsewhere in the Report.

A similar process took place for humanitarian goods with respect to overpricing. In contrast to the broadly traded, standard commodity nature of the oil market, however, it is difficult to generalize about the pricing and quality of the wide variety of humanitarian and other goods imported. While the United Nations, through a division of the OIP, made efforts to monitor the pricing, the investigation suggests that these efforts had limited success.

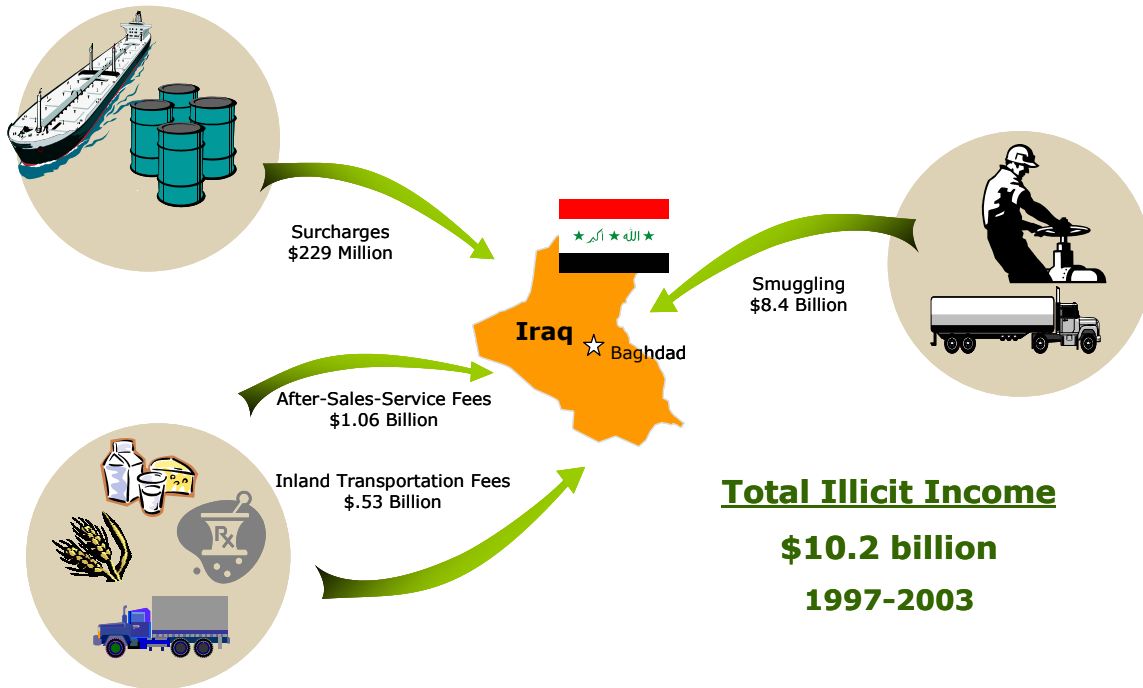
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Chart B – Illicit Income Received by Iraq During the Programme (1997-2003)



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## VII. MALADMINISTRATION OF THE PROGRAMME

On October 1, 1997, Secretary-General Annan indicated that the Secretariat's management of all activities relating to the Programme would be consolidated in OIP under Mr. Sevan. Thus, OIP assumed administration of *both* the sanctions aspects of Resolution 661 and the humanitarian aspects of the Programme under Resolution 986. When she arrived as Deputy Secretary-General in March 1998, Ms. Fréchette was given overall responsibility for the Secretariat's role in the Programme and it was to her that Mr. Sevan formally reported. However, Mr. Sevan continued to have direct access to the Secretary-General about Programme-related issues.

### A. THE EXECUTIVE DIRECTOR AND OIP

Mr. Sevan served in the position of Executive Director of OIP from its inception in October 1997 until the end of the Programme in 2003. In his capacity as the Executive Director, Mr. Sevan played an active role in the Programme's administration. He participated in the preparation of the Secretary-General's 90 and 180-day reports to the Security Council. According to OIP officials, Mr. Sevan would edit and scrutinize the reports before further review by the Deputy Secretary-General and signature by the Secretary-General. Similarly, Mr. Sevan took the lead in addressing the 661 Committee on matters that were critical to the Programme. For example, Mr. Sevan routinely addressed the 661 Committee on the subject of expediting the approval of Programme-related contracts and the need to authorize funding for the Iraqi regime's oil production infrastructure. His subordinates regarded him as the person responsible for reporting sanctions and Programme violations, including the Iraqi regime's receipt of kickbacks, to the Security Council and the 661 Committee. In addition, Mr. Sevan often discussed matters concerning the Programme with senior Iraqi officials.

Mr. Sevan had access to the United Nations' highest officers—Secretary-General Annan and Deputy Secretary-General Fréchette as well as Mr. Riza, who was then Chef de Cabinet. Mr. Sevan spoke to Ms. Fréchette nearly every day on matters pertaining to the Programme and frequently met with Secretary-General Annan and Mr. Riza. Mr. Sevan enjoyed Deputy Secretary-General Fréchette's trust, as a result of which she granted Mr. Sevan substantial discretion to make decisions regarding the direction of the Programme and to interact as he saw fit with the 661 Committee.

It seems clear to the Committee that, throughout the implementation of the Programme, there were various management failures and challenges occurring within OIP under Mr. Sevan's leadership. For example, Mr. Sevan: (1) failed to embrace OIP's responsibilities with respect to sanctions monitoring; (2) withheld critical evidence from the 661 Committee of reports of kickbacks on humanitarian contracts; (3) marginalized the important oversight role of the Programme Management Division; and (4) did not ensure that the Contracts Processing and Monitoring Division possessed adequate resources and expertise to scrutinize Programme-related contracts. Mr. Sevan's failures are all the more troubling when considered against his corrupt receipt of oil allocations from the Iraqi regime from which he profited.

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Within OIP, the customs experts were responsible for “examin[ing] each contract, in particular the details of price and value, and whether the items to be exported [were] on the [distribution plan].” These customs experts, moreover, were expected to scrutinize contracts for possible fraud and deception by the Iraqi regime.

In February of 1998, the Secretary-General recommended an increase in the size and scope of the Programme, and process improvements to alleviate existing problems and support the increased size and scope of the Programme. These changes and augmentation to the Programme required CPMD to adapt, through increased staffing and revised review and approval procedures.

The Security Council then authorized an increase to the ceiling on oil exports from \$2 billion to \$5.256 billion dollars per phase, causing a dramatic increase in the number of contract applications flowing into CPMD for review. With the increased funding, the Secretary-General also approved the addition of several new sectors beyond the original focus on food and medicine. These sectors brought about more complex contracts for highly-specialized goods intended to upgrade the infrastructure of Iraq. On June 19, 1998, the scope of the Programme was further enlarged when the Security Council, for the first time, authorized funding for oil spare parts.

The impact was felt most intensely by the customs experts. From some hundreds of contracts, volume grew over time to 4,000 contracts, while items covered by those contracts grew from a low of about 8,500 to a high of nearly 185,000 line items from a greatly expanded list of permissible import sectors. Moreover, the contracts became more complex, with the inclusion of deferred payments, performance bonds, training elements, etc. Whatever the growth elsewhere in CPMD, there was no commensurate increase in size or broadening of the customs experts’ expertise.

The net result was that price evaluations on contracts were not accurate—though it was recognized within OIP that this constituted a major responsibility, and it was recognized that the “customs experts” in place were not actually experts in international commodities markets. Limited reviews were therefore the norm. In other words, OIP could not determine if the price in a given contract had enough head room to permit the payment of kickbacks, and detailed information was not given to the 661 Committee.

After OIP began administering the Programme on behalf of the Secretariat, coordination of the Programme’s field operations occurred across several divisions. In the field, operations were carried out by a Humanitarian Coordinator who was charged with running UNOHCI. From New York, Mr. Sevan’s Executive Office and the Programme Management Division (“PMD”) interfaced with UNOHCI.

The key functions of PMD were to provide policy and management advice to OIP’s Executive Director and to support the work of UNOHCI relating to the implementation and observation of the Programme in the field. PMD was also tasked with coordinating the preparation of the 90 and 180-day reports of the Secretary-General to the Security Council and ensuring that the Programme was effectively implemented. PMD further was charged with providing strategic

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thinking on the development and planning of the Programme and identifying Programme-related issues.

At least, that was how it was supposed to work. In practice, PMD's mandate, as interpreted and directed by the Executive Director, Mr. Sevan, was much woollier and more circumscribed. There was never an agreement on the structure and relationships in OIP, an organizational confusion that was compounded by unilateral adjustments made by Mr. Sevan. As an example, there was a major decision by Mr. Sevan, who is described elsewhere in this Report by Deputy Secretary-General Louise Fréchette as "a one-man band," to sever communication lines between UNOHCI and PMD. This effectively emasculated PMD in fulfilling many of its roles. The overall effect was to marginalize PMD—whose name was even changed by Mr. Sevan to remove the word "Management" from its title.

On the ground in Iraq, operations were carried out by a Humanitarian Coordinator who was charged with running UNOHCI and also served as the Secretariat's representative in Iraq. He was accountable to Mr. Sevan and was responsible for managing the Programme's implementation in Iraq. Each succeeding Humanitarian Coordinator was based in Baghdad and supported by a Deputy Humanitarian Coordinator, also located in Baghdad, as well as one in the northern Iraqi governorate of Erbil.

Resolution 986 and the Iraq-UN MOU provided that while the United Nations was responsible for implementing the Programme in the three northern governorates, the regime would be responsible for implementing the Programme in the fifteen governorates in the southern and central regions of Iraq. UNOHCI's role was to observe the equitable distribution of humanitarian supplies by the former Iraqi regime, verify the efficiency of the operation, and determine the adequacy of available resources to meet the humanitarian needs of the Iraqi people. In order to accomplish these functions, the Humanitarian Coordinator was responsible for managing the United Nations' observation mechanism in Iraq.

Here again, the picture on the ground differs from the theory described above. UNOHCI did develop procedures for managing the Programme, but its authority to enforce them was compromised by OIP's overriding authority over the purse strings, effectively holding a veto over the funding of the Agencies' projects.

Beyond these basic management breakdowns within OIP, perhaps most significant was the failure of Mr. Sevan to respond appropriately to the serious reports of large-scale Programme violations as Iraq initiated its various schemes to derive illicit income from contractors under the Programme. With respect to the kickback scheme, the 661 Committee undoubtedly had a degree of awareness and bore some responsibility. However, OIP was particularly well-positioned to receive information and to confirm the true scope of the Iraqi regime's activities. Further, under Resolutions 661 and 986, the Secretariat was required to report to the Security Council regarding the Programme's implementation, including sanctions violations. Notwithstanding such responsibility, the Secretariat did not divulge the full extent of the information in its possession—despite numerous requests by the 661 Committee for it to do so. More particularly, during the Programme, OIP received a significant amount of written evidence regarding illicit payments in connection with Programme-related contracts from both suppliers and numerous member state



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missions. This documentation indicated that the kickback scheme, which was pervasive and extended to almost all contracts executed from mid-2000 onward, included specific company names, contract numbers, bank accounts, and amounts paid. However, no meaningful action was taken, and not one of the numerous 90 or 180-day reports submitted to the Security Council mentioned the illicit payment demands in connection with Programme contracts.

## B. OVERSIGHT FROM THE 38<sup>TH</sup> FLOOR

Management failures in OIP under the direction of Mr. Sevan have been recorded. But Mr. Sevan does not bear all responsibility alone. His management of the Programme was subject to oversight from the 38<sup>th</sup> Floor of the United Nations—from the Secretary-General and Deputy Secretary-General. In particular, the Secretary-General designated the Deputy Secretary-General to oversee Mr. Sevan and OIP, including approval of the 90 and 180-day reports to the Security Council. Mr. Sevan spoke to the Deputy Secretary-General about the Programme nearly every day and routinely provided her with notes and memoranda concerning significant Programme-related issues. Mr. Riza, the Secretary-General's Chef de Cabinet, also frequently involved himself in issues pertaining to the Programme and advised the Secretary-General accordingly.

As Chef de Cabinet, Mr. Riza headed the Executive Office of the Secretary-General. His responsibilities included assisting both the Secretary-General and the Deputy Secretary-General “in the exercise of executive direction in relation to the work of the Secretariat and of United Nations programmes and other entities within the Organization.” Both the Deputy Secretary-General and Mr. Riza served with other officials as members of the Secretary-General's Senior Management Group, which was required to meet on a weekly basis “to ensure strategic coherence and direction in the work of the Organization” and, in part, to “advise the Secretary-General on all matters of policy that affect the Organization as a whole.”

When interviewed by the Committee, the Secretary-General, the Deputy Secretary-General, and Mr. Riza each struggled to rationalize the role of the 38<sup>th</sup> Floor in overseeing OIP. Instead, they offered conflicting views of their own responsibilities as well the functions of Mr. Sevan vis-à-vis the Programme. These inconsistencies demonstrate a basic confusion within the highest offices of the Secretariat.

The Secretary-General told the Committee that the Programme was managed by the 661 Committee, and he went as far as to assert that Mr. Sevan “worked” for the 661 Committee. While clearly Mr. Sevan was the United Nations official who worked most closely at senior levels with the 661 Committee, his responsibilities did not dilute in any way the Secretary-General's administrative and management responsibilities for Mr. Sevan. He, after all, both appointed and promoted Mr. Sevan. Moreover, the Secretary-General, not the 661 Committee, had authority to remove Mr. Sevan and otherwise to supervise his management of the Programme.

The Secretary-General has acknowledged, as he must, that the 38<sup>th</sup> Floor had a role to play with respect to the Programme. He explained that the Deputy Secretary-General served as “an extra pair of eyes” for the Secretariat. The Secretary-General expected his Deputy to ensure that Mr. Sevan raised issues with the Government of Iraq and reported Programme-related matters to the

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661 Committee. The Deputy Secretary-General was also charged with reviewing and clearing the 90 and 180-day Reports for the Secretary-General's signature and transmittal to the Security Council.

The Deputy Secretary-General, like the Secretary-General, also has described a limited role for the 38<sup>th</sup> Floor in managing the Programme. She explained to the Committee that Mr. Sevan worked "very closely with the 661 Committee." She noted that she was theoretically charged with overseeing the Programme. However, the Deputy Secretary-General told the Committee that it never actually worked that way. She stated that Mr. Sevan had an ongoing relationship with the Secretary-General and Mr. Riza. Questions concerning Mr. Sevan's decision-making were to be addressed to the Secretary-General. More generally, according to Ms. Fréchette, "if the Secretariat is performing to the satisfaction of the member states, the 38<sup>th</sup> Floor does not get involved." Because the Deputy Secretary-General did not receive any complaints about Mr. Sevan, she assumed that there were no issues and therefore left Mr. Sevan to handle matters with 661 Committee. She saw the 38<sup>th</sup> Floor as becoming involved only if the future and viability of the Programme was threatened. In her view, the Programme was "well run"; therefore, there was no reason for her proactive supervision of OIP.

The Deputy Secretary-General ultimately conceded that, in hindsight, she should have asked more questions and played a greater role in ensuring that sanctions violations were addressed. But, throughout her interviews with the Committee, the Deputy Secretary-General maintained that she was not responsible for overseeing the Programme on behalf of the Secretariat or for supervising Mr. Sevan. Her description of her own role contrasts dramatically with the Secretary-General's express delegation of supervisory authority—however unclearly that may have been expressed. In her interviews with the Committee, Ms Fréchette maintained that despite the Secretary-General's delegation of oversight authority, "[i]t never happened that way."

Mr. Riza similarly distanced himself from responsibility for OIP. Mr. Riza acknowledged involvement in the creation of OIP in October 1997 and discussions with the Secretary-General and the Iraqi ambassador regarding the regime's intent to impose surcharges on oil sales in November 2000. Otherwise, he claimed no substantive involvement.

But Mr. Riza played a greater role than he was willing to state. He routinely received copies of significant documents and memoranda concerning the Programme. His role was to screen for materials that warranted the Secretary-General's attention. His own handwritten notes reveal that he closely reviewed the materials that Mr. Sevan forwarded and frequently met with the Secretary-General and Mr. Sevan to discuss major matters concerning the Programme. With far greater frequency than the Deputy Secretary-General, Mr. Riza also participated in meetings with Iraqi officials relating to the Programme.

When viewed against the basic mechanics of OIP and its role in managing the Programme on behalf of the Secretariat, the competing descriptions of the 38<sup>th</sup> Floor's role evince a reluctance to accept responsibility for the significant management failures that occurred within OIP during the life of the Programme.

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One of the primary functions of the Secretariat in its administration of the Programme was to ensure that information gathered by OIP through its operations in the field and through its review of Programme-related contracts flowed to the 661 Committee. As the Secretary-General explained, 90 and 180-day reports on the implementation of the Programme were designed to provide the Security Council with a sense of the effectiveness of the Programme “on the ground,” and “to share with [the Security Council] what has happened and what we’re doing and what we’re achieving or not achieving.”

When interviewed by the Committee, the Secretary-General insisted that the Programme was “a very transparent operation”—“one of the most transparent programs [he has] seen” in terms of the process it required for reports to be made by the Secretariat to the Security Council. However, significant information was routinely withheld from the 661 Committee. Despite mounting evidence of a widespread kickback scheme, the Secretary-General’s quarterly reports never mentioned the emerging problem. In hindsight, the Secretary-General told the Committee that detailed information concerning the Iraqi regime’s receipt of kickbacks should have been conveyed to the 661 Committee and should have been discussed in his quarterly reports or even a special report to the Security Council. The Deputy Secretary-General and Mr. Riza similarly acknowledged that such detailed information in the possession of OIP needed to be transmitted to the 661 Committee. The impression on the 38<sup>th</sup> Floor may have been that the Programme was transparent. In fact, it was not.

The Secretary-General, Mr. Riza, and to a lesser extent the Deputy Secretary-General, each appreciated the importance of ensuring the transparency of OIP’s operations and any difficulties that OIP encountered. Despite confusion as to the responsibilities of the 38<sup>th</sup> Floor, there was relative clarity about the Secretariat’s role in reporting issues concerning the Programme to the Security Council. Nonetheless, pertinent information was omitted from the reports, information that Secretary-General Annan, Deputy Secretary-General Fréchette, and Mr. Riza each knew about and that, when interviewed, each agreed in retrospect should have been communicated to members of the Security Council.

To be sure, the Secretary-General and the Deputy Secretary-General were apparently not aware of the full scope of evidence that OIP had accumulated, and, clearly, Mr. Sevan bears responsibility for withholding information. There is no indication, for example, that Mr. Sevan advised the Secretary-General or the Deputy Secretary-General of the detailed information concerning kickback payments that the director of PMD accumulated in December 2000 and the even clearer evidence that OIP’s chief customs expert documented in October 2001. But the Secretary-General and the Deputy Secretary-General (and Mr. Riza) were aware of the kickback scheme at least as early as February 2001. The Secretary-General discussed the kickback allegations and other sanctions violations with Mr. Sevan on numerous occasions.

Indeed, from recent interviews, it is evident that the Secretary-General paid attention to the Programme and was familiar with many of the key issues, such as the expansion of the Programme and the need to eliminate barriers to processing humanitarian contracts. Furthermore, on one occasion, the Secretary-General reported to the Security Council the Iraqi regime’s illicit receipt of oil surcharges, albeit in an abbreviated form. He further recalled discussing the kickback allegations with members of the Security Council on an informal basis. When asked to

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reflect on his handling of the Programme, the Secretary-General explained that he believed that he acted properly. The fact remains, however, that despite multiple opportunities, the Secretary-General, the Deputy Secretary-General, and Mr. Sevan never formally reported the kickback scheme to the Security Council through quarterly reports or otherwise.

The Secretary-General recognized concerns about the Iraqi regime taking unilateral action. He further told the Committee that “giving Saddam Hussein the right to select” contractors was a significant design flaw in the Programme. While recognizing the United Nations’ exposure to abusive practices by the Iraqi regime, the 38<sup>th</sup> Floor failed to take meaningful steps to ward off and minimize such threats to the Programme. For example, no evidence has been found that the 38<sup>th</sup> Floor confronted Iraqi officials when reports of Programme abuses surfaced.

The Deputy Secretary-General’s claim, when interviewed, that there were no issues requiring her attention is at odds with her own concessions that she knew at the time of significant Programme-related issues. For example, the Deputy Secretary-General was well aware of the Iraqi regime’s smuggling of oil and told the Committee that, as of November 2000, the re-opening of the Syrian pipeline diverted revenue streams away from the United Nations’ humanitarian effort. She admitted knowledge of the regime’s receipt of surcharge payments and, in fact, received numerous notes from Mr. Sevan on the subject of payments to the regime generated from oil sales. Similarly, Ms. Fréchette eventually conceded that she was aware of the kickback scheme as of March 2001.

Apart from reports and evidence of sanctions violations, the Deputy Secretary-General also knew of disputes within OIP, including complaints that PMD’s director J. Christer Elfverson raised about Mr. Sevan’s style of management and the deep resentment that existed between Mr. Sevan and Humanitarian Coordinator Hans von Sponeck. Still further, the Deputy Secretary-General knew of the Government of Iraq’s delays in issuing visas for United Nations personnel to operate in Iraq.

The Deputy Secretary-General had many reasons to question Mr. Sevan and, in fact, eventually conceded that there “were a few signals” indicating that the Programme was amiss. The documents and witness accounts chronicled herein reveal more than just “a few signals.” The Deputy Secretary-General knew about—but did not act upon—many reports of major Programme violations.

## **C. SUMMATION**

In the final analysis, Mr. Sevan ran a \$100 billion Programme with very little oversight from the supervisory authority that created his position and OIP. Through a combination of an unclear reporting structure, a lack of supervision by the 38<sup>th</sup> Floor, and a general unwillingness to recognize and address significant issues on the part of the Secretary-General and the Deputy Secretary-General, Mr. Sevan had substantial autonomy to shape the Programme’s direction. He failed to resist and challenge the Iraqi regime’s rampant sanctions violations through which the regime diverted billions of dollars away from the humanitarian effort. He failed to properly investigate and monitor sanctions violations. And he failed to disclose pertinent information to the 661 Committee about the actions by the Iraqi regime.

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Mr. Sevan's failures should have been evident on the 38<sup>th</sup> Floor. The Deputy Secretary-General suggested that the Programme was "well run," but in the end acknowledged that "in retrospect there was a growing problem of kickbacks that should have been given greater prominence . . . with respect to myself and the Secretary-General."

There was little real oversight from the 38<sup>th</sup> Floor of Mr. Sevan's activities and, in particular, of his response, or lack thereof, to reports of Iraqi abuses of the Programme to obtain illicit income from oil surcharges and humanitarian kickbacks. The record amply demonstrates a number of instances where there was a lack of support for and oversight of the Programme by the Secretary-General. Some of the problems identified by the Committee are: (1) a delegation to Deputy Secretary-General Fréchette that was neither clear nor appropriately monitored; (2) an inadequate response to and investigation of reports of Iraqi abuses and corruption of the Programme, in part by failing to ensure that reports of Programme violations were brought to the attention of the 661 Committee and the Security Council; (3) a lack of adequately ensuring that the sanctions objective of the Programme received appropriate attention; and (4) a failure to provide adequate oversight of the Executive Director of OIP, Benon Sevan.

This is not to say that had the 38<sup>th</sup> Floor more aggressively supervised Mr. Sevan the failures of OIP would have been eliminated. Nor is it to overlook the significant role and authority of the 661 Committee in guiding the Programme's affairs. But Mr. Sevan and OIP retained an immensely important role in the day-to-day administration of the Programme and interaction with the Government of Iraq. The 38<sup>th</sup> Floor had a substantially greater role to play. A check on Mr. Sevan was clearly needed, but no meaningful control was exercised.

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## **VIII. AGENCIES: THE PROGRAMME IN THE THREE NORTHERN GOVERNORATES**

During the 1980s, Saddam Hussein began a systematic relocation and genocide of Kurdish populations in northern Iraq. Tens of thousands of Kurds were killed during this campaign. In 1991, after the first Gulf War, the Kurds rebelled, resulting in the Government of Iraq's withdrawal of its military forces and political officials. The United States subsequently created and enforced a no-fly zone over the three northern governorates.

As acknowledged by Security Council Resolution 986, the situation in the three northern governorates of Erbil, Dohuk, and Suleimaniyah presented special problems for the architects of the Oil-for-Food Programme. Because of the oppression suffered by Kurds in northern Iraq at the hands of Saddam Hussein's government and the implied protection of coalition forces, these governorates operated semi-autonomously, while still legally part of Iraq.

After parliamentary elections in 1992, the two largest Kurdish parties—the Kurdistan Democratic Party (“KDP”) and the Patriotic Union of Kurdistan (“PUK”)—formed a coalition government. However, the parties had a long history of mutual acrimony. This pattern continued in spite of the coalition, resulting in two separate regional centers: one including Erbil and Dohuk, controlled by the KDP; and the other including Suleimaniyah, controlled by the PUK.

In addition, following the first Gulf War and the withdrawal of Iraqi troops from the three northern governorates, Saddam Hussein imposed an embargo on the region, which remained in effect until the Programme began. As a result, the Kurdish population in the north suffered doubly—from sanctions imposed by the Security Council and those imposed by Baghdad.

For the reasons cited above, Resolution 986 and the Iraq-UN MOU established a framework for delivering humanitarian aid in the north that differed from that projected for the southern and central governorates. Specifically, the United Nations Inter-Agency Humanitarian Programme (“UNIAHP”), on behalf of the Government of Iraq, was given full responsibility for delivering humanitarian aid in the three northern governorates.

The Agencies achieved crucial successes early in the Programme in the northern governorates—most notably managing a humanitarian crisis and distributing much-needed goods and services throughout the region. However, their implementation of the Programme in the north also yielded a number of notable failures. These can be ascribed primarily to: (1) the Agencies tackling problems and projects beyond their core competencies; and (2) the fact that the Agencies' activities in northern Iraq were fraught with insufficient management, coordination, and oversight within and among the Agencies.

Some of the Agencies were either advisory or regulatory bodies with little or no experience in the implementation of actual infrastructure projects involving construction or engineering components. The consequences were outright failures of projects, or projects delayed and poorly managed, at best. Illustrations are numerous. ITU failed to rehabilitate the telecommunications system in the north. UNESCO could not construct a functional chalk factory, the need for which

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was questionable in any case, nor could WHO deliver either one large (400-bed) hospital or a series of smaller ones. UN-Habitat, charged with finding housing for internally displaced persons (“IDPs”), did not maintain and vet eligibility lists, making it susceptible to the pressures of local authorities, which had their own priorities and favorites, usually not including IDPs. UN-Habitat also seems to have bent to the priorities of the local authorities, who favored infrastructure projects (e.g., roads, bridges) rather than increases in the housing stock.

Among the Agencies, ineffective coordination and oversight compounded the problems of extending their activities beyond their normal parameters. It is probably no exaggeration that the kinds of projects for which they assumed responsibility under the Programme were unique in their scope and magnitude. For many it was the largest project ever undertaken and also designed with a very different funding model.

Normally, in undertaking projects in countries outside Iraq, Agencies would get approval and voluntary funding from governments and other donors. In this construct, governments and donors would expect, and get, periodic progress reports. For the implementing agency, there would be an incentive to perform well as performance history would impact on the funding of future projects. By contrast, for Agencies’ projects under the Programme, funds were sourced from the proceeds of oil sales, but the Agencies were not in any way directly responsible to the Government of Iraq.

There was also a muddled answer to the basic management question—who is in charge? Supposedly, OIP was, overall, but it was thousands of miles away in New York. On the ground, OIP had delegated responsibilities to UNOHCI. In the end, the responsibility for wasted resources, duplicative efforts, and failed project implementation was not clear.

Neither OIP nor UNOHCI seemed prepared to use their control of the source of project funding to manage the largely autonomous Agencies. There was no real system or framework within which UNOHCI (or anyone else) could effectively coordinate the Agencies’ activities. The Agencies themselves resisted coordination or oversight from outside their own organizations. These factors were complicated or compounded by poorly defined relationships between and among Agencies, with the Iraqi government, and with the local authorities in the three northern governorates.

The Agencies, with the exception of WFP, also suffered from a lack of sufficient qualified senior staff. This was, in part brought about by high turnover, largely due to the short-term nature of personnel contracts. The Programme had to be renewed every 180 days, and the Agencies, except UNICEF, were unwilling to risk contracts with staff, which exceeded this six month period. The result: lack of knowledge of conditions in the areas in which the Agencies were operating; this in turn slowed procurement, contributing to delays in project implementation, low morale, and unhappy local authorities.

Throughout, the job was made harder for United Nations entities implementing the Programme because of the manipulative and unhelpful actions of the Government of Iraq. Always resistant to a large United Nations presence in Iraq, the Government of Iraq systemically delayed granting visas for United Nations personnel—even though this was promised in the Iraq-UN MOU. The Iraqis also capriciously declared certain United Nations personnel “*personae non gratae*”

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(especially British and American citizens), delayed clearance for the delivery of goods and services, exerted selective pressures on local hires, and resisted projects that might benefit the northern population. To some degree, no doubt largely to entice cooperation from the Government of Iraq, the Agencies adjusted their activities to accommodate these pressures.

In spite of many of these inhibiting factors, the Programme largely achieved its immediate purpose of distributing food. While successful at basic food distribution, the Programme fell well short of what should have been accomplished, given the substantial funds available. The Agencies failed to take advantage of the substantial funds available, and, in many cases, their implementation of projects was poor.

At another level, the Committee has not singled out individual corruption in the Programme in Iraq, largely because of limitations resulting from the unsettled conditions prevailing in Iraq throughout the period of the Inquiry (as well as time constraints). However, particularly in the north, even greater access to witnesses may not have taken possible cases of corruption forward, due to the lack of a banking system and the difficulties of tracing financial transfers in the resultant cash economy.

At the same time, weakness in control and oversight contributed to an environment conducive to corruption. Certainly, there were thefts of large amounts of cash from various offices of the Agencies (e.g., \$300,000 from UNESCO, \$90,000 from an FAO office plus \$40,000 after a car accident, and \$64,000 from a WHO sub-office). Added to these events, it appears that the Agencies did not thoroughly investigate allegations of the misappropriation of funds, mismanagement, or conflicts of interest. In fact, a legal consultant to UNDP stated that conditions in Iraq required flexibility in interpreting and executing rules.



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**IX. PROGRAMME ADMINISTRATIVE COSTS**

**A. AGENCY ADMINISTRATIVE EXPENSE RECOVERY**

In general, “various operational and administrative costs” of the United Nations in implementing the Programme were intended to be paid from a special account for administrative expenses, known as the ESD Account. That account was funded with 2.2 percent of the proceeds generated by Iraqi oil sales under the Programme. In its First Interim Report, the Committee reviewed in detail the Secretariat’s spending from this account, mainly by OIP and UNOHCI. The forensic analysis concluded that expenditures of ESD funds were properly accounted for and, with rare exceptions, made in accordance with policy and budget decisions. The actual expenditures were related to direct Programme costs, mainly for personnel.

In the case of the Agencies involved in the Programme, the question of how to compensate them for certain overhead costs was raised at an early stage. The Agencies maintained that these indirect costs, known as Programme Support Costs (“PSC”), should be added to reimbursement of direct costs to compensate fully their Programme work. In part, the Agencies argued that because PSC are based on indirect expenses, such as headquarters management time, they are not precisely quantifiable and could not be billed directly to the Programme. In addition, the Agencies asserted that they had no source for financing such costs and that ordinarily in undertaking projects like the Oil-for-Food Programme they include a charge for PSC based on total expenditures.

Paying PSC was vigorously opposed by Jean-Pierre Halbwachs, the United Nations Controller, as inconsistent with both Resolution 986 and the practice within the Secretariat, and as possibly dangerous in terms of disturbing the balance struck with the Iraqi regime on the relationship between humanitarian expenditures and administrative expenditures. At the urging of Security Council members anxious to get the Programme underway rapidly and effectively, the resistance of Mr. Halbwachs to the payment of PSC was overcome, with the apparent concurrence of Secretary-General Annan.

The Agencies, therefore, were ultimately reimbursed for their direct expenses and for a percentage, generally three percent, of both their direct expenses and their Programme expenditures for humanitarian assistance. Further, the amounts reimbursed to the Agencies for direct expenses included a substantial number of headquarters staff.

The resulting reimbursements are reflected in the table below:

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Table 5 – Administrative Costs of the Agencies (in USD thousands)

	Direct Costs	Total PSC	Total Administrative Costs	% PSC to Direct Costs
WFP	\$96,568	\$11,361	\$107,929	11.8%
FAO	\$90,938	\$16,491	\$107,429	18.1%
UNICEF	\$68,208	\$13,922	\$82,130	20.4%
UNDP	\$61,531	\$18,721	\$80,252	30.4%
UN-HABITAT	\$62,823	\$15,127	\$77,950	24.1%
WHO	\$50,653	\$10,461	\$61,114	20.7%
UNOPS	\$37,699	\$10,483	\$48,182	27.8%
UNESCO	\$28,773	\$4,246	\$33,019	14.8%
ITU	\$8,890	\$1,138	\$10,028	12.8%
<b>TOTAL</b>	<b>\$506,083</b>	<b>\$101,950</b>	<b>\$608,033</b>	<b>20.1%</b>

As can be seen above, about \$102 million was paid to the Agencies for PSC. On the average, they were paid about twenty percent over and above direct costs. The substantial differences among the Agencies were influenced by the volume and value of expenditures for goods in northern Iraq.

The investigation has found that PSC provisions for other programs or projects of the Agencies generally have been negotiated with fund donors in a range of three to thirteen percent. The Committee agrees that the Agencies' rationale has force and that there is precedence for departing from the strict and narrow interpretation of "operating and administrative" expenses employed by the Secretariat itself in confining reimbursement only to direct costs.

However, the method chosen—the levy of a fixed percentage of total project expenditures on top of direct cost reimbursement—is highly arbitrary, without explicit rationale, and appears generous in consideration of the number of headquarter staff costs that were reimbursed directly.

## B. POST-INVASION PROGRAMME

After the Coalition Provisional Authority ("CPA") assumed responsibility for winding down the Programme in the summer of 2003, the Security Council mandated that the United Nations perform two significant tasks: first, contract for and provide emergency supplies; and, second, prioritize and amend contracts already in place. For its part, the United Nations decided to employ the Agencies. Moreover, a different approach towards reimbursing the Agencies was taken, an approach that is difficult to defend.

Rather than reimburse the Agencies for their direct costs plus PSC, the United Nations decided to pay the Agencies a flat percentage of the value of the contracts for emergency supplies they would purchase and of contracts that they would be prioritizing and amending. The United Nations decided on a seven percent rate for work performed to acquire and distribute emergency

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supplies immediately after the invasion (Resolutions 1472 and 1476), and proposed a three percent rate for work performed to prioritize and amend existing contracts (Resolution 1483). The percentage allocation for Resolution 1483, after strong internal debate, was dropped from three to one percent. The two tasks combined produced \$179 million for work over a five month period. The amounts reimbursed for the earlier amendment required more complex work from the Agencies, and there appears to be a consistent relationship between direct expenditures and reimbursements, agency by agency. However, for the later work, there appears to be no consistent relationship between costs and reimbursements. In total, the amount of fees paid under Resolution 1483 was clearly excessive, as admitted to the Committee's investigators. Direct costs and overhead were approximately \$17.5 million and fees collected were \$66 million.

**Table 6 – Resolutions 1472, 1476, and 1483 Costs (in USD thousands)**

	SCR 1472 Fees	SCR 1483 Fees	Total
WFP	\$55,851	\$16,876	\$72,727
UNDP	\$23,340	\$10,655	\$33,995
UNOPS	\$3,590	\$19,019	\$22,609
FAO	\$15,149	\$6,293	\$21,442
WHO	\$10,810	\$3,270	\$14,080
UNICEF	\$4,119	\$4,082	\$8,201
UN-HABITAT	–	\$3,928	\$3,928
UNESCO	–	\$1,956	\$1,956
ITU	–	\$385	\$385
<b>Total</b>	<b>\$112,859</b>	<b>\$66,464</b>	<b>\$179,323</b>

In that light, and after consultation with officials of the United Nations and the Agencies, the Committee strongly recommends that the equivalent of up to **\$50 million** in the aggregate be made available by Agencies for the benefit of Iraq, either by program support or by cash payment. Fair compensation to third parties is necessary to enable the United Nations to complement its core resources with competent outside specialists, such as the Agencies. However, the United Nations should ensure that such compensation does not result in egregious profits.

## C. MISSTATEMENT OF PROGRAMME ADMINISTRATIVE COSTS

A decision was made at the start of the Programme that, in seeking reimbursement for PSC, only the portion related to direct administrative costs would be taken from the ESD Account (2.2 percent Account). The payment of PSC on three percent of the costs of humanitarian goods would instead be charged against the humanitarian account for the northern governorates (ESC Account). Similarly, and for reasons not entirely clear to the Committee, a decision was made also to pay other administrative fees from the humanitarian account for central and southern Iraq (ESB Account).

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The United Nations' financial statements and accounting records reflect Programme administrative costs of \$902 million. However, the net effect of the decisions just cited has been, as an accounting matter, to understate by \$313 million administrative expenses in the United Nations accounts. The accounts reserved for the purchase of humanitarian goods were reduced by the use of the accounts for some administrative costs.

**Table 7 – Programme Funding for Administrative Charges (in USD thousands)**

	Funding for Administrative Charges			
	ESD	ESC	ESB	Total
Agency Admin. Charges	\$474,329	\$133,703	\$179,324	\$787,356
UN/OIP/UNOHCI Admin. Charges	\$428,160			\$428,160
<b>Total</b>	<b>\$902,489</b>	<b>\$133,703</b>	<b>\$179,324</b>	<b>\$1,215,516</b>

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## X. CONTROL AND OVERSIGHT

The Committee's earlier Briefing Paper and its First Interim Report covered certain critical aspects of the Programme's internal audits. These earlier reports concentrated on the scope and effectiveness of the Internal Audit Division ("IAD") within the Office of Internal Oversight Services ("OIOS"), located in the Secretariat under the authority of an Under-Secretary-General. Created in July 1994, OIOS is the first United Nations office specifically concerned with fraud, abuse, waste, and corruption within the Organization.

Further investigation reviewed in this Report extends the analysis to the internal and external audits of the nine UN-related Agencies engaged in implementing the Programme, the work of the Board of Auditors ("BOA"), and the Investigations Division of OIOS ("OIOS ID").

### A. INTERNAL AUDITS OF THE AGENCIES

The internal auditing efforts of the Agencies' had much in common with the IAD audits discussed in the First Interim Report: too little, too late, and with too few resources. Planned or requested audits were frustrated by lack of funding, staff, and management support.

The resources devoted to Programme audits by the nine UN-related Agencies varied substantially, and the scope of their audits ranged from the small and specific (e.g., the hiring of water tankers) to Programme-wide. In total, there were only sixty-six internal audits—less than one audit per agency per year. FAO alone accounted for half of these internal audits; several of the Agencies only had two or three, and ITU had none.

Despite the size of Programme expenditures, the established auditing resources of the Agencies were increased little, if at all, so coverage fell below their normal standards and well below private sector standards. There were instances in which audits were curtailed by lack of staff, and, in some instances, the Agencies' management failed to respond to requests for extra funding.

The audit reports made over 1,150 recommendations. There was a striking similarity in these audit findings and recommendations across the Agencies and the years. About half of the audit findings were related to internal control deficiencies in operating and financial policies. Some of these problems can be attributed to the difficult operating environment. However, an apparent absence of follow-up to audit findings in many cases or consequences for managers who failed to address deficiencies were symptomatic of the lack of authority and status for internal audit.

Appropriately, the top audit or oversight officials in the Agencies were responsible to the relevant Agencies' executive heads and reported to the Agencies' external governing body. With one exception, the Agencies' auditing committees were chaired and staffed by insiders rather than qualified independent members. Concerns were raised at one point by the 661 Committee about transparency and accountability as the Programme greatly increased in size. OIP generally met with resistance when attempting to obtain the Agencies' internal audit reports. It is unclear if the Agencies ever provided OIP with these reports. Similarly, extensive discussion among OIOS and

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the Agencies about the value of “horizontal audits,” covering activity across the Agencies, never led to concrete results.

Clearly, Agencies value their relative independence, and resist change that might place organs of the Secretariat—in this case OIP or OIOS—in a supervisory role over their own staff. In addition, member states were not as well positioned as usual to monitor the Agencies’ activities. Ordinarily, when member states provide voluntary contributions to particular agencies, they have an understandable incentive to exercise appropriate—and potentially more effective—oversight. But in the specific case of the Programme, the Agencies’ financing came from a common source (Programme funds), and concerns of particular member states therefore may have been diluted or even absent.

## **B. EXTERNAL AUDITS**

Almost from its beginning, the United Nations Organization has had independent auditors responsible for auditing the financial statements of both the Secretariat and the Agencies. The United Nations is audited by the Board of Auditors (“BOA”), which is composed of three rotating auditors general of member states who draw on their national staffs for specific audits. The Agencies are audited by members of the Panel of External Auditors of the United Nations (“the Panel”), on which members of the BOA also sit.

In concept, it was recognized that the Programme required oversight and review, and formal reports were addressed to the Secretary-General and forwarded to the General Assembly, OIP, the 661 Committee, and the Government of Iraq. Unfortunately, the scope of the external audits of the Programme was limited to the escrow accounts and the Secretariat; these audits did not encompass the Agencies’ operations.

The mandate of the BOA is broad, and its stated policy is that staffing and funding are determined by perceived needs. The difficulty is that, in practice, they have accepted a limitation on their budget and, in respect of the Programme, the BOA purview was defined narrowly, focusing particularly on the accuracy of financial statements. That is reflected both in the limited amount spent by the BOA in connection with the Programme (approximately \$1 million or an average of \$110,000 per audit) and the complete failure to identify any fraud or corruption. The internal control environment of Programme activity received little attention and even seemed to diminish as the Programme grew, and serious problems began to be rumored or known.

External auditors from the Panel performed biennial audits on the Agencies’ financial statements, and all such statements received unqualified audit opinions. The external auditors also submitted management letters that addressed financial and management issues arising during their work. On the average, Agency administrative expenditures for Programme activities only accounted for five percent of their total spending. As a consequence, there appeared to be no specific focus on auditing Programme-related activities.

In any event, an opportunity was lost: the United Nations bodies conceptually most equipped to provide a disciplined, professional view of the management of the Oil-for-Food Programme failed to rise to the challenge.

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## **C. UNITED NATIONS INVESTIGATIONS DIVISION**

Significantly, even though located in the Secretariat, the authority of OIOS ID extends to separately administered funds and programs. Because of funding limitations, however, OIOS ID mainly reacts to specific indications of problems rather than initiating proactive program reviews.

The mission of OIOS ID is essentially fact-finding. Reports may be made to the General Assembly, the Secretary-General, and—in the case of suspected criminal activity—appropriate national authorities. United Nations staff members are obligated to cooperate with investigations, and OIOS has access to all United Nations documents. But there is no obligation for outside parties, including contractors, to cooperate, and there is no record of disciplinary action against United Nations employees for non-cooperation.

During the years of its existence, OIOS ID has received a growing number of complaints, and its staff has more than doubled to a current total of thirty-four in four locations. However, only a fraction of complaints are actively investigated.

Significantly, for extra-budgetary activities like the Programme, funding is controlled by managers whose program the OIOS ID intends to investigate. Requests for greater funding and staffing during the Programme years were denied by Mr. Sevan.

Given what is known, it is striking that OIOS ID received relatively few Programme-related cases, most of them as late as 2002 and 2003. Moreover, only limited investigation was undertaken. Some of the problem was absence of cooperation by the Iraq authorities, but it is evident that lack of funding and other resources were important constraints.

The conclusion is unavoidable that the United Nations Organization up and down the line did not fully accept or support the mission of OIOS ID. Financing and staffing were inadequate, “whistle blower” protection non-existent, and the willingness of program managers to support aggressive investigation was generally absent, certainly in the case of the Oil-for-Food Programme. Moreover, the authorized ability of OIOS ID to extend the scope of its work throughout the United Nations Organization has never been exploited.

These clear limitations on OIOS ID’s performance were not balanced by the two other United Nations offices with inspection and oversight authority. Neither the Monitoring, Evaluation and Consulting Division of OIOS nor the Joint Inspection Unit performed any review or evaluation of the Programme.

## **D. CONCLUSIONS**

The review of the oversight of the Programme, particularly auditing, reveals clear inadequacies in staffing and financing in the UN-related Agencies as well as in the Secretariat. Little effort was spent to achieve consistency and coordination over Agencies participating in the Programme. Programme managers could frustrate initiatives of both auditors and investigators, and there was an absence of, or inability to use, clear reporting lines to “the top” or to a truly independent board.

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At least as important, these failings appear symptomatic of the absence of a strong organizational concern with maintaining protection against inefficiencies, fraud, and corruption. For example, the BOA, which was the longstanding independent oversight body with extensive authority and mandate for auditing the Organization as a whole, interpreted its mandate narrowly, focusing mainly on the financial accounts of the Programme. The oversight functions of the Organization need to be greatly strengthened, and the Committee's recommendations in this respect are set forth later in this Report.



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## **XI. GENERAL CONCLUSIONS**

Broadly, the Committee's conclusions address the adequacy of political oversight and direction, the capacity of the Secretariat to administer its responsibilities under the Programme, the United Nations' ability to provide financial oversight and control to the Programme, and the question of persuading the entities in the United Nations' highly decentralized system to work effectively and efficiently together in an enterprise of this complexity and size.

The Committee's conclusions and recommendations are generally consonant with recommendations by others who have urged and are urging early action on United Nations reform. However the Committee cannot help but note that many of these recommendations, some of which are both detailed and holistic, have in large measure lain fallow for long periods of time, some for over a decade.

The Committee makes two contributions to the reform debate. First, the depth to which the Committee has analyzed the Programme leads uniquely to a detailed background from which the Committee's recommendations have come. Second, the Committee's analysis of the Programme confirms that reform is urgent. It suspects that the weaknesses in structure and ethic within the Programme may well be symptomatic of a wider malaise throughout the United Nations.

In short, this investigation leads to the firm belief that reform is necessary if the United Nations is to regain and retain the measure of respect among the international community that its work requires. As important, the Committee believes that action must be taken now. The urgency to pursue fundamental reform of the Organization is heightened by a sense that, in this volatile world, roughly analogous situations demanding sanctions, enforcement of sanctions, and/or humanitarian relief are more than likely to recur.

### **A. THE SECURITY COUNCIL STRUGGLED**

The Security Council struggled in clearly defining the broad purposes, policies, and administrative control of the Programme. Resolution 986 followed prior failed efforts to engage the Government of Iraq in an oil-for-food program. As a result, there appears to have been conflicting sentiments between treating Iraq with enough "flexibility" to get its agreement to a program and a concern to retain sufficient control that any program would not become a doorway to the clandestine reinvigoration of Iraq's ambitions for weapons of mass destruction. In the end, on one hand, far too much initiative and decision-making was left to the Iraqi regime while on the other, the Security Council took the extraordinary step of retaining, through its 661 Committee, substantial elements of administrative, and therefore operational, control. That turned out to be a recipe for the dilution of individual and institutional responsibility. When things went awry—and they did—when troublesome questions of conflict between political objectives and administrative effectiveness arose, decisions were delayed, bungled, or simply avoided—no one was in charge.

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## **B. ADMINISTRATIVE AND PERSONNEL STRUCTURE NOT ADEQUATE**

The Committee recognizes that the United Nations was faced with an extraordinary challenge, replete with conflicting political pressures, for which it was ill-equipped in terms of experience and administrative capacity.

Indeed, the Committee believes that “professional disciplines” at the United Nations are weak and eroded. As a consequence, the Secretariat, from its most senior levels, proved unable to deal effectively with the political pressures. There also appears to be a pervasive culture resistant to accountability and prone to escaping responsibility. The Secretariat was also hampered in effectively carrying out its functions under the Programme through an absence, at the time, of suitable administrative infrastructure for dealing with the sudden demands of this exceptionally large and complex “temporary” humanitarian program.

From what it has seen of the Programme’s operations, the Committee considered whether the United Nations could reasonably limit operational responsibility to such areas as peacekeeping, where experience has led to the creation of some degree of permanent infrastructure. Ultimately, the Committee was convinced that, in a world where a myriad of considerations inform crises in a volatile and often violent environment, that approach would deprive the world of a needed resource.

If the United Nations is to fulfill that mission, the fault lines and flaws uncovered during the investigation clearly demand that the Organization’s administrative capacity be strengthened. To this end, the Committee has made a series of recommendations, which are outlined elsewhere in this Report. The key point is that the Organization and its Secretary-General need a stronger structure at the top. A Secretary-General is, de facto, the Organization’s chief political and diplomatic officer. In unsettled times, those responsibilities tend to be all consuming. The present Secretary-General, widely respected for precisely those very qualities, has regrettably been undercut by lapses in the administration of the Organization.

The United Nations Charter designates the Secretary-General as Chief Administrative Officer. But whatever the founders had in mind, the Secretary-General—any Secretary-General—has not been chosen for managerial or administrative skills, nor has he been provided with the instruments needed for strong executive control, most clearly in the area of personnel, where professional competence must compete with the political demands of member states.

A Secretary-General needs stronger support. That need has been recognized, in part, by the creation in 1998 of the new post of Deputy Secretary-General. However, the results of the investigation suggest that the role of Deputy Secretary-General as “Chief Operating Officer” must be strengthened and made more explicit. The Committee proposes that the Deputy Secretary-General be appointed by the General Assembly on the recommendation of the Security Council, as is the case with the Secretary-General.

While ultimately responsible to the Secretary-General, the Chief Operating Officer should have direct authority for personnel, budgeting, and other key administrative functions with access to the Security Council and General Assembly as needed.

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**C. LACK OF EFFECTIVE CONTROLS**

Most notable among the administrative failures of the Programme was a grievous absence of effective controls and audits. In both areas, the Organization has in recent years worked to develop competence, but it has been from a standing start. The Oil-for-Food Programme exemplified the weakness of planning, the lack of adequate funding, and the paucity of manpower, even after the Programme went on and on. As important structurally was a palpable absence of authority and clear, if any, reporting lines, especially to the Secretariat's senior management. As a consequence, needed independence was lost. Line managers could and did divert auditing initiatives, and follow-up to critical findings was erratic at best.

**D. INSTANCES OF CORRUPTION REFLECT CONTROL WEAKNESSES**

The instances of corruption detailed in the Committee Reports—corruption that reached to the top of the Programme management—are an important reflection of control weaknesses. The Committee's concern is that these influences are symptomatic of an absence of a strong institutional ethic—an ethic that should reflect the unique and crucial role of the United Nations system in exemplifying and encouraging the highest standards in which corrosive corruption—private and public—has been far too common. The General Assembly, Security Council, and Secretariat have been insufficiently conscious of the serious risks posed by not enforcing ethical standards, both to the Organization's credibility and to its internal morale.

**E. LACK OF INTER-AGENCY COORDINATION**

The particular nature of the Oil-For-Food Programme placed in stark relief the difficulties of effective cooperation across the Agencies. There was and is no simple way accurately to track Programme expenditures across agency lines. The presumption of central budget authority was not matched by an ability to assess actual spending (much less the effectiveness of spending), or to insist on common accounting standards or treatment. Clearly, the demand for inter-agency action inherent in the Oil-for-Food Programme was exceptional. Arguably, such demands are unlikely to be repeated in so dramatic a fashion. But surely the difficulties perceived should not be tolerated in lesser programs.

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## **XII. MAJOR RECOMMENDATIONS**

### **A. CREATE THE POSITION OF CHIEF OPERATING OFFICER**

Create the position of Chief Operating Officer (“COO”). The COO would have authority over all aspects of administration and would be appointed by the General Assembly on the recommendation of the Security Council. The position would report to the Secretary-General, and the United Nations Charter should be amended as appropriate.

Creation of this position would serve to better insulate United Nations administrators from political pressures distorting management decisions. It would provide sufficient authority for effective management discipline and would free the Secretary-General of some of the duties inherent in the role of the chief administrative officer.

### **B. STRENGTHEN INDEPENDENCE OF OVERSIGHT AND AUDITING**

Establish an Independent Oversight Board (“IOB”) with a majority of independent members and an independent chairman. In discharging its mandate, the IOB should have functional responsibility for all audit, investigation, and evaluation activities, both internal and external, across the United Nations Secretariat and agencies substantially funded by the United Nations and whose leadership is appointed by the Secretary-General. The IOB should be particularly concerned with overseeing and monitoring:

1. Implementation of risk-based planning across the United Nations system;
2. Implementation of oversight, audit, and investigation best practices;
3. Implementation of a consistent framework for assessing findings and recommendations and bringing significant oversight issues to the attention of the Secretary-General/Director-Generals and the General Assembly/Governing Bodies;
4. Investigations and improvements in the ethics and integrity of the Organization; and
5. The efficiency and effectiveness of the oversight function.

In the interests of transparency, there should be annual disclosure from the IOB to the General Assembly of the planned audit coverage and the actual results of oversight activity. IOB oversight reports should be publicly accessible. The IOB should consult with and coordinate as appropriate with all UN-related agencies.

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#### **C. IMPROVE COORDINATION AND THE OVERSIGHT FRAMEWORK FOR CROSS-AGENCY PROGRAMS**

The Programme demonstrated the need for significant improvements in the oversight of cross-agency programs, particularly regarding common principles, planning, transparent financials, and resources. The IOB should provide the needed coordination.

1. Establish high level coordinating bodies for all major cross-agency relief and emergency programs and provide them with real decision making ability, agreed to by all participating entities; these coordinating bodies should be empowered to set, implement, and enforce principles and policies;
2. Improve the following aspects of cross-agency programs by:
  - Promulgating, subject to audit, appropriate policies and procedures;
  - Documenting processes for rapid deployment and rapid response projects identifying areas of risk and applicable critical controls necessary to be in place to mitigate exposure; and
  - Developing standard audit plans for programs;
3. Ensure that each program has consolidated financial statements that are subject to external and internal audit; and
4. Make sufficient oversight resources available immediately and integrate them into the management and implementation of a new program. Mandate the creation of a rapid deployment audit program with investigatory presence (“rapid integrity”) that allows oversight to begin at the inception of a new program.

#### **D. REFORM AND IMPROVE MANAGEMENT PERFORMANCE**

Strong and effective leadership and management is essential to the success of the United Nations’ mission. There is a need for the United Nations to strengthen the quality of its management and management practices. To this end:

1. Improve the scope and quality of the internal management review processes by mandating periodic, high-level executive reviews against clear objectives of all major initiatives and activities;
2. Ensure that senior management and professional staff adhere to the highest standards of accountability and transparency in their performance, and remove those who do not meet these performance requirements;
3. Seek opportunities for peer review of management performance; and

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4. Overhaul the management hiring, promotion, evaluation, and reward methodology basing each on key tasks, and agreed measures of performance.

**E. EXPAND CONFLICT-OF-INTEREST AND FINANCIAL DISCLOSURE REQUIREMENTS**

The financial disclosure requirement must extend well below the current Assistant Secretary-General level within the Organization and should also specifically include the Secretary-General and the Deputy Secretary-General. Financial disclosure requirements must include all United Nations staff who have any decision-making role in the disbursement or award of United Nations funds (e.g., Procurement Department, Office of the Controller).

A strong financial disclosure program is an integral part of creating an institutional culture that recognizes and understands actual, potential, and apparent conflicts of interest. The United Nations' conflict-of-interest rules and regulations need to be expanded and better defined so that they encompass actual, potential, and apparent conflicts of interest.

**F. COST RECOVERY**

The Committee recognizes that fair compensation to third parties is necessary to enable the United Nations to complement its core resources with competent outside specialists, such as the Agencies. However, the United Nations should ensure that such compensation does not result in egregious profits.

Agencies involved in the Programme should return up to \$50 million in excess compensation secured as a result of work performed under Security Council Resolution 1483.

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**XIII. ANNEX 1: BIOGRAPHIES OF COMMITTEE MEMBERS**

**CHAIRMAN**

**Paul A. Volcker**

In the course of his career, Mr. Volcker worked in the United States federal government for almost 30 years, culminating in two terms as Chairman of the Board of Governors of the United States Federal Reserve System from 1979-1987. He divided the earlier stages of his career among the Federal Reserve Bank of New York, the United States Treasury Department, and the Chase Manhattan Bank.

Mr. Volcker retired as Chairman of Wolfensohn & Co. upon the merger of that firm with Bankers Trust. Currently, he is Chairman of the Board of Trustees of the International Accounting Standards Committee, overseeing a renewed effort to develop consistent, high-quality accounting standards acceptable in all countries. In 2003, he headed a private Commission on the Public Service, recommending a sweeping overhaul of the organization and personnel practices of the United States federal government.

Educated at Princeton University, Harvard University, and the London School of Economics, Mr. Volcker is Professor Emeritus of International Economic Policy at Princeton University and was the first Henry Kaufman Visiting Professor at the Stern School of Business at New York University.

**MEMBER**

**Justice Richard Goldstone**

After practicing at the Johannesburg Bar in South Africa, Justice Goldstone was appointed to the Transvaal Supreme Court in 1980. In 1989 he was appointed Judge of the Supreme Court of Appeal and from July 1994 to October 2003, he was a Justice of the Constitutional Court of South Africa. He is currently Distinguished Jurist-in-Residence at the University of San Diego in the United States.

From 1991 to 1994, he served as Chairperson of the Commission of Inquiry regarding Public Violence and Intimidation in South Africa. From August 1994 to September 1996, he served as the Chief Prosecutor of the United Nations International Criminal Tribunals for the former Yugoslavia and Rwanda. During 1998, he was the chairperson of a high level group of international experts that met in Valencia, Spain, and drafted a Declaration of Human Duties and Responsibilities for the Director General of UNESCO (the Valencia Declaration). From August 1999 until December 2001, he was the chairperson of the International Independent Inquiry on Kosovo. In December 2001, he was appointed as the chairperson of the International Task Force on Terrorism that was established by the International Bar Association and is now the co-chairman of its Human Rights Institute.

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Among awards he has received are the International Human Rights Award of the American Bar Association (1994) and Honorary Doctorates of Law from universities in Canada, Israel, the Netherlands, South Africa, the United Kingdom, and the United States. He is an Honorary Bencher of the Inner Temple, London, an Honorary Fellow of St Johns College, Cambridge, and an Honorary Member of the Association of the Bar of New York. He is a Foreign Member of the American Academy of Arts and Sciences. He serves on the boards of Human Rights Watch, Physicians for Human Rights, and the International Center for Transitional Justice.

#### MEMBER

##### **Mark Pieth**

Mark Pieth has been Professor of Criminal Law and Criminology at the University of Basel, Switzerland. He completed his studies, his PhD in criminal procedure and his habilitation thesis on sanctioning and broader criminological topics at this University; after an extensive period abroad at the Max-Planck-Institute for Criminal Law and Criminology, Germany and the Cambridge Institute of Criminology, United Kingdom, and a time in private practice at the Bar, he was Head of Section on Economic and Organised Crime in the Swiss Federal Office of Justice from 1989 to 1993. In this position he was involved in drafting legislation against money laundering, organised crime, drug abuse and corruption and on the confiscation of assets.

Prof. Pieth has acquired extensive experience in international fora, most notably as a member of the Financial Action Task Force on Money Laundering (FATF) between 1989 and 1993 and as Chair of the OECD Working Group on Bribery in International Business Transactions since 1990.

Prof. Pieth has served as Dean of the Faculty of Law at the University of Basel. He has also assumed various presidencies and memberships of national commissions in Switzerland (President of the Expert Group of the National Research Programme on Violence and Organised Crime, Former President of the Federal Commission on Data Protection in the Medical Profession, Member of the Swiss Federal Gaming Commission, Member of the Consultative Commission to the Federal Administration of Finances on the Prevention of Money Laundering). He has been a consultant to corporations, international organisations and foreign governments on issues related to governance and a facilitator to the Wolfsberg AML Banking Initiative.



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**XIV. ANNEX 2: THE MANDATE OF THE INDEPENDENT INQUIRY COMMITTEE**

The Committee is tasked with collecting and examining information relating to all aspects of the administration and management of the Programme, from its inception to its transfer to the CPA, including allegations of fraud and corruption on the part of United Nations officials, personnel and agents, as well as contractors of the United Nations or Iraq under the Programme.

Committee reports are submitted to the Secretary-General with the understanding that they will be made public. Such reports shall provide a full explanation of the support for its findings. The rights of those implicated to respond to findings and any undertaking by the Committee as to confidentiality of interviews or other information are to be respected.

The Committee's investigation proceeds on the authority of the terms of reference agreed between its Chairman and the Secretary-General of the United Nations, buttressed by the unanimously adopted Security Council Resolution 1538 of April 21, 2004. That resolution welcomed the appointment of the Independent Inquiry and called upon all member states (including their regulatory authorities) to cooperate fully, by all appropriate means, with the Inquiry. The Secretary-General has explicitly and repeatedly instructed United Nations employees to cooperate fully and to preserve and make available to the Committee United Nations records of all kinds. He was also explicit in his expectation that all United Nations staff will cooperate fully. He has been clear that violation of this instruction would lead to disciplinary action.

The Secretary-General set forth the following terms of reference to guide the Committee's investigation:

The independent inquiry shall collect and examine information relating to the administration and management of the Oil-for-Food Programme, including allegations of fraud and corruption on the part of United Nations officials, personnel and agents, as well as contractors, including entities that have entered into contracts with the United Nations or with Iraq under the Programme:

- (a) to determine whether the procedures established by the Organization, including the Security Council and the Security Council Committee Established by Resolution 661 (1990) Concerning the Situation between Iraq and Kuwait for the processing and approval of contracts under the Programme, and the monitoring of the sale and delivery of petroleum and petroleum products and the purchase and delivery of humanitarian goods, were violated, bearing in mind the respective roles of United Nations officials, personnel and agents, as well as entities that have entered into contracts with the United Nations or with Iraq under the Programme;
- (b) to determine whether any United Nations officials, personnel, agents or contractors engaged in any illicit or corrupt activities in the carrying out of

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their respective roles in relation to the Programme, including, for example, bribery in relation to oil sales, abuses in regard to surcharges on oil sales and illicit payments in regard to purchases of humanitarian goods;

- (c) to determine whether the accounts of the Programme were in order and were maintained in accordance with the relevant Financial Regulations and Rules of the United Nations.

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## XV. ANNEX 3: FINDINGS

The Committee makes no formal findings with respect to the Security Council. However, the Committee does believe that the Security Council failed to clearly define the broad parameters, policies, and administrative responsibilities for the Programme. This lack of clarity was exacerbated by permitting the Iraqi regime to exercise too much initiative in the Programme design and its subsequent implementation. Compounding that difficulty, the Security Council, in contrast to most past practice, retained through its 661 Committee substantial elements of administrative control. Neither the Security Council nor the Secretariat leadership was in overall control.

### A. THE SECRETARIAT AND OIP

#### Secretary-General Kofi Annan

As the Chief Administrative Officer of the United Nations, the Secretary-General carried oversight and management responsibilities for the entire Secretariat. That particularly included auditing and controls functions that had demonstrable problems with respect to the Programme, as discussed elsewhere in this Report.

In terms of the Programme itself, the record amply demonstrates a number of instances where there was a lack of support for and oversight of the Programme by the Secretary-General. Some of the problems identified by the Committee are: (1) a delegation to Deputy Secretary-General Fréchette that was neither clear nor appropriately monitored; (2) an inadequate response to and investigation of reports of Iraqi abuses and corruption of the Programme, in part by failing to ensure that reports of Programme violations were brought to the attention of the 661 Committee and the Security Council; (3) a lack of adequately ensuring that the sanctions objective of the Programme received appropriate attention; and (4) a failure to provide adequate oversight of the Executive Director of OIP, Mr. Sevan.

In sum, in light of these circumstances, the cumulative management performance of the Secretary-General fell short of the standards that the United Nations Organization should strive to maintain.

In making these findings, the Committee has recognized both the difficult administrative demands imposed upon the Secretariat and the Secretary-General both by the design of the Programme, and the overlapping Security Council responsibilities.

#### Deputy Secretary-General Louise Fréchette

With respect to Deputy Secretary-General Fréchette, the Committee finds that the Deputy Secretary-General, apparently uncertain of her role, did not provide the degree of leadership and oversight that the complex Programme required. The scope of the delegation by the Secretary-General to the Deputy Secretary-General was not a model of

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clarity, but the Deputy Secretary-General failed to seek clarification. Moreover, the Deputy Secretary-General knew that it was her role to oversee Mr. Sevan. The Deputy Secretary-General's oversight of Mr. Sevan was not adequate. The Deputy Secretary-General offered very little direction to Mr. Sevan, particularly on matters concerning the sanctions violations. The Deputy Secretary-General acknowledged that it was her role to ensure that the Secretary-General's quarterly reports to the Security Council were accurate and complete. Yet the Deputy Secretary-General failed to have included any reference to the kickback scheme in the many reports forwarded to the Security Council during the Programme.

#### Benon Sevan

Mr. Sevan failed to maintain and support OIP's responsibilities with respect to sanctions monitoring and to properly investigate and monitor sanctions violations, withheld critical evidence from the 661 Committee and the Security Council of reports of kickbacks on Programme-related contracts, marginalized the important role of the Programme Management Division, and did not ensure that the Contracts Processing and Monitoring Division possessed adequate resources and expertise to scrutinize Programme-related contracts.

## **B. THE SELECTION OF COTECNA INSPECTION S.A.**

#### Secretary-General Kofi Annan

Recent evidence raised further questions about whether the Secretary-General was aware of Cotecna's contract bid, leading the Committee to re-examine the issue. After careful examination, this new evidence does not change the Committee's prior finding on this issue.

The Committee carefully reviewed the additional Kojo Annan telephone billing records that make clear that in the autumn of 1998 Kojo Annan placed calls to the procurement department and that at other times he also called the Secretary-General. However, the pattern of calling times is not clearly suggestive that Kojo Annan discussed Cotecna's interest with the Secretary-General. The remaining records disclosed by Kojo Annan do not reflect communications between Kojo Annan and the Secretary-General about Cotecna's contract bid.

With respect to the memorandum of December 4, 1998, Mr. Wilson's description of "discussions" with the "SG and his entourage," the witnesses do not support Mr. Wilson's account, and he himself has refuted it. This supports the Secretary-General's denial that such a meeting occurred. Moreover, there is no evidence that Cotecna credited or acted upon the Wilson message. Serious questions persist about the character and credibility of Mr. Wilson. The Committee thus has little assurance that he did not conjure an account of discussions with the Secretary-General in order to make himself appear more important to his principals at Cotecna.

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The Committee therefore affirms its prior finding that weighing all of the evidence and the credibility of witnesses, the evidence is not reasonably sufficient to conclude that the Secretary-General knew that Cotecna had submitted a bid on the humanitarian inspection contract in 1998.

The Committee also affirms its prior finding that no credible evidence exists that the Secretary-General influenced, or attempted to influence, the procurement process in 1998 leading to the selection of Cotecna.

As to the adequacy of the Secretary-General's response to press reports in January 1999 of a possible conflict of interest, the Committee reemphasizes its earlier conclusion that the Secretary-General was not diligent and effective in pursuing an investigation of the procurement of Cotecna. What is now known about Kojó Annan's efforts to intervene in the procurement process underscores the Committee's prior finding that a thorough and independent investigation of the allegations regarding Kojó Annan's relationship with Cotecna was required in 1999. A resolution of the questions much earlier would likely have resolved the issues arising from the Cotecna bid process and the consequent conflict of interest concerns.

#### Kojó Annan

Contrary to earlier statements by Kojó Annan to the Committee, the evidence now indicates that at relevant times Kojó Annan had contacts with the section of the United Nations procurement office directly concerned with the 1998 humanitarian inspection contract to be awarded under the Programme. Kojó Annan was not forthcoming to the Committee with respect to his statements to the Committee that he had no involvement with Cotecna's bid for the humanitarian inspection contract.

Also in 1998, Kojó Annan used his father's name and position in the purchase and delivery of a car, which resulted in a reduced price and a remission of duties. There is no record that his direct request to his father to permit him to purchase the car in the name of the Secretary-General was granted.

#### Cotecna, Elie Massey, Robert Massey

Despite numerous requests made by the Committee, Cotecna failed to timely disclose critical documents, including: (1) a November 1998 memorandum from Robert Massey to Elie Massey and Mr. Wilson, copied to Kojó Annan; (2) a December 4, 1998 memo from Mr. Wilson to Cotecna senior management; and (3) a Cotecna Consultancy Agreement with Kojó Annan effective March 1, 1999. The Committee further finds that Elie Massey was not forthcoming to the Committee regarding Kojó Annan's involvement in the inspection contract selection process. Finally, Robert Massey was not forthcoming to the Committee regarding Kojó Annan's involvement in the inspection contract selection process and his employment with Cotecna in 1999.

#### Michael Wilson

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Mr. Wilson has not been forthcoming and has offered conflicting statements to the Committee with respect to: (1) his own involvement in the process by which Cotecna was awarded the humanitarian inspection contract; (2) whether Kojo Annan was involved in the contract process; and (3) whether he authored a December 4, 1998 memo of mission activities in Paris.

## **C. THE COST OF ADMINISTERING THE PROGRAMME**

1. The Committee finds that there were inadequate controls in place to ensure a sound review of important financial decisions relating to the Programme. The United Nations Controller was placed in the position of having to take sole responsibility for important decisions that ultimately had a material effect on the Programme's expenditures and its financial reporting. Responsibility for large-scale financial decisions should not rest on one individual alone. In particular, the Programme would have benefited from review by ACABQ or some other authoritative budgetary body.
2. The Committee finds that there was inadequate support and justification for the establishment of the three percent rate for PSC and that, as the Programme grew in size and duration, this rate should have been reviewed and reassessed for reasonableness. The three percent PSC rate resulted in nearly \$102 million in payments to the Agencies—in addition to the \$500 million paid to them for direct administrative costs relating to their administration of the Programme.

The Committee finds also that there was inadequate support and justification for the rates adopted to compensate the Agencies for work performed under Resolutions 1472, 1476, and 1483. Although the United Nations found that the original three percent rate established for Resolution 1483 was excessive and reduced it to one percent, the resulting payments to the Agencies still were grossly higher than their costs. The Committee estimates that the United Nations overpaid the Agencies by nearly \$49 million for work performed under Resolution 1483.

3. The Committee finds that the funding for administrative costs was neither transparent nor in accordance with the relevant resolutions. The Committee identified over \$300 million in administrative costs and fees that were charged to the humanitarian accounts for northern Iraq ("ESC Account") and for central and southern Iraq ("ESB Account") rather than to the Programme's administrative account ("ESD Account"). This resulted in a significant misstatement of the Programme's accounts and decreased the balance of funds available for the purchase of humanitarian goods.

## **D. ASSESSMENT OF PROGRAMME OVERSIGHT**

1. The Committee finds that the funding and staffing levels for Programme oversight services, including internal audit, external audit, and investigations, were insufficient.

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Extra-budgetary endeavors, such as the Programme, did not have an independent mechanism to determine the necessary funding for oversight.

Considered both in relation to United Nations and public company benchmarks, an endeavor of the Programme's magnitude and complexity required internal audit resources many times greater than what actually was in place.

The refusal of OIP's management to allocate sufficient funds and its reluctance to obtain visas for investigations staff particularly impeded the achievement of adequate staffing levels and prevented OIOS ID from fully carrying out its duties.

Although BOA is not subject to any restraint on levels of staffing and funding, in the Committee's view, the resources it applied to Programme auditing were inadequate and well below public company benchmarks.

Because none of the existing governing bodies—the General Assembly, the Security Council, or the Agencies' governing bodies—addressed all of the Programme's many inter-connected aspects, appropriate funding and staffing were never allocated for the coordinated review of risks and audit planning across the Programme.

2. The Committee finds that key areas of the Programme were neither adequately nor timely reviewed.

Internal and external auditors failed to audit and test properly some of the Programme's most critical areas—including pricing of oil and humanitarian goods—and to assess their impact on the Programme's financial statements.

For the most part, the Agencies' internal audits began far too late in the Programme.

BOA audit planning appears to have been inconsistent, and the areas subject to review varied by year. Furthermore, despite the Programme's increasing complexity in 2000, the number of areas addressed in BOA's audit reports declined significantly.

External audit review of Programme activities in the Agencies was very limited because the reviews were carried out within the context and materiality of the Agencies' overall operations.

Audit coverage was further limited by the absence of any agreement that the Agencies, OIOS, and OIP coordinate Programme internal oversight and the fact that no policy mandates required coordination and communication across the various UN-related Agencies.

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3. The Committee finds that OIP management, the General Assembly, and the Security Council, were not provided with audited financial statements and internal audit reports that comprehensively covered all aspects of the Programme and highlighted deficiencies impacting the Programme's effectiveness.

BOA's audits of the Programme's accounts were reported in a timely manner, but internal audit reports were not published in a timely manner and in a consistent format, and they were not made available to OIP, the General Assembly, or the Security Council.

Moreover, audit findings and recommendations were frequently not implemented in a timely fashion, and often were ignored. There is no evidence suggesting that there were consequences for managers responsible for programs subject to adverse audit comments or for managers who failed to implement audit recommendations.

The Programme had potentially quantifiable aims such as effective and efficient humanitarian relief, and improving the health and nutrition of the Iraqi people. However, the Programme's overall goals were not specified and were not subject to evaluation and monitoring by internal oversight.

4. The Committee finds that the disjointed and sometimes overlapping approach to oversight left a number of contentious issues unresolved, including:

OIP and the 661 Committee were very concerned that they were not receiving copies of the Agencies' audit reports. OIP attempted to amend its memoranda of understanding with the Agencies to require the Agencies to share their audit reports with OIP. The Agencies resisted this attempt, and the issue never was fully resolved.

OIOS likewise requested copies of the Agencies' audit reports in order to better coordinate and audit the Programme. The Agencies similarly resisted this request, and the issue was not resolved.

5. The Committee finds several deviations from "best practices."

Areas in which internal oversight did not conform to best practice included: (a) lack of direct reporting to an independent oversight board; (b) failure to perform risk assessments to professional IIA standards; and (c) lack of budgetary independence.

The evidence available to the Committee suggests that BOA did not consistently follow its audit standards and that there were technical shortfalls in its approach to risk assessment, planning and testing during the Programme. This finding is supported by the variability of the areas covered in BOA's audit reports from year to year, the high risk areas not consistently addressed in its reports, its



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approach to detection and reporting of fraudulent transactions, and the lack of comment on the internal control weaknesses described in internal audit reports.

The Committee finds that BOA paid insufficient attention to the risks of fraudulent manipulations of Programme income and spending by the Iraqi regime and that, by the 2000-01 biennium, should have qualified its attestations regarding the Programme's financial statements.

OIOS ID is generally not supported and accepted across the United Nations by both management and staff. This, together with a lack of a whistleblower protection policy, prevents OIOS ID from successfully carrying out its mandate.

## E. MANAGEMENT OF PROGRAMME FUNDS

1. The Committee finds that, in managing Programme funds, Treasury adhered to all aspects of CPPI—except in respect to the concentration of funds on deposit at BNP and at the five other investing institutions, which well exceeded the limits allowable under CPPI.
2. The Committee finds that Treasury was cognizant of credit risks very early in the Programme and actively sought to resolve the matter with the Government of Iraq, which initially resisted Treasury's attempts at letter-of-credit and investment diversification. As early as 1997 and repeatedly thereafter, Treasury notified the Secretariat, the 661 Committee, and the Government of Iraq of this issue. Treasury succeeded in partially mitigating this credit risk by, soon after the Government of Iraq's approval, expeditiously diversifying a portion of the funds held at BNP. However, the Committee further finds that the United Nations' inability to diversify the Programme's letter-of-credit operations, once approved by the Government of Iraq in late 2000, unnecessarily subjected Programme funds to continued risk.
3. The Committee further finds that Treasury adequately assessed the risks relating to the Government of Iraq's request to shift to euro-denominated oil sales. Treasury analyzed the possible impact of this shift on several critical areas, including oil pricing, the receipt and investment of funds, financial reporting, and humanitarian goods purchases. In addition, Treasury estimated the monetary impact from pricing crude in euros and earning lower returns on euro-denominated investments.

The Committee finds that Treasury's overall investment results compared favorably to the relevant market indices. Funds held in the ESB Account earned a rate of return slightly higher than the Fed Funds and EONIA rates. Returns on the other Programme accounts far outpaced the Fed Funds rate and other market benchmarks, most notably after the United Nations' pooling of investments, which provided for longer maturities, larger tranches of investments, more favorable rates, and lower fees. Based on BOA's testing and the Committee's sample testing, investment earnings appear to have been properly credited back to each Programme fund. Finally, even though the amounts in question were not systematically verified, OIP

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and the Accounts Department diligently ensured that interest earned and reported by the Agencies on Programme funds was properly credited back to the escrow account.

## F. PERFORMANCE OF THE UN-RELATED AGENCIES

1. The Committee finds that the Agencies were responsible for many successful initiatives that had a significant and beneficial effect on the lives of the citizens in the three northern governorates. These included the implementation of a successful food distribution program and the construction and rehabilitation of vital infrastructure in the three northern governorates.
2. Nevertheless, the Committee finds that the Agencies' delivery of aid suffered from several significant shortcomings that substantially reduced the Programme's effectiveness and resulted in wasted resources:
  - a. Some of the Agencies undertook projects for which they lacked relevant experience and technical expertise, often resulting in those Agencies' failure to implement important projects. Responsibility for this shortcoming rests not only with the Agencies, but also with OIP and UNOHCI, which in some cases chose the ill-equipped Agencies and failed to respond adequately when an agency was unable to complete successfully a particular initiative.
  - b. The humanitarian program in the three northern governorates suffered from defects in management, coordination, and oversight. These defects manifested themselves in several different ways:
    - i. OIP and its arm in the field, UNOHCI, failed to adequately control and supervise the activities of the Agencies, who resisted any attempts at supervision by OIP and UNOHCI. To a large degree, this was because the Programme's design did not specifically provide avenues for this control and supervision, and OIP and UNOHCI were reluctant to utilize the one tool at their disposal—the control over Programme funds—to manage the activities of the Agencies. Moreover, the Agencies were resistant to OIP's and UNOHCI's attempts at supervision.
    - ii. Management defects within some of the Agencies themselves included undefined lines of authority, poor communication among various departments or sections within some of the Agencies, and ineffective controls and oversight that contributed to the existence of a corruption-prone environment.
    - iii. Both the Government of Iraq and the local authorities in the three northern governorates sometimes influenced inappropriately the Programme's implementation in the three northern governorates for personal or political benefit. Occasionally, some of the Agencies yielded to this influence.

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3. The Committee also finds that there were significant instances where the Agencies failed to implement successfully projects and initiatives—even though the projects fell within the Agencies' traditional spheres of competency. These failures both wasted resources and delayed the provision of needed aid to the three northern governorates.

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**XVI. ANNEX 4: SUMMARY OF THE HUMANITARIAN IMPACT OF THE PROGRAMME (“WORKING GROUP” STUDY)**

With the publication of this Report on the Management of the Oil-for-Food Programme, the Committee has issued also a report by an independent “Working Group” of experts comprising eight researchers at institutions worldwide. The Working Group’s study is titled: “The Impact of the Oil-for-Food Programme on the Iraqi People.” The following is the Working Group’s summary of its study; the full version is published in a separate volume.

**A. POSITIVE IMPACTS**

The food supplies provided through the Programme reversed a serious and deteriorating food crisis, preventing widespread hunger and probably reducing deaths to which malnutrition was contributing. By 1994-1995, the average food supplies had fallen to a level where inadequacy was inevitable (estimated as below 2,000 kcal). Without the Programme, the drop in food supplies would have continued, falling even further with the severe drought in 1999-2001. After food supplies funded by the Programme started arriving in 1997, the average supplies climbed to between 2,500 and 3,000 kcal, a level likely to have covered the needs of most of the population. The supplies stayed at that level, including compensation for a collapse in local production in 1999-2002 due to infrastructure failure and drought. The numbers of people for whom hunger was mitigated cannot be estimated from the data, but most of the Iraqi population undoubtedly benefited.

While food intakes may have been nearly adequate in quantity with the Programme, the diet quality was very unsatisfactory for extended periods. It is likely that malnutrition due to deficiencies in vitamins and minerals increased, particularly anemia in women and young children, and subclinical deficiencies of a range of nutrients are probable.

Equipment and medical supplies from the Programme were delivered sporadically and in an uncoordinated manner, which reduced much of their effectiveness. This was in part due to administrative procedures and “holds” imposed by the 661 Committee, and a number of other factors that complicated the ordering and delivery procedures, including lack of cooperation by the Government of Iraq. The medical supplies undoubtedly also saved many lives—but there is no way of estimating the number—but at the same time many preventable deaths and unnecessary suffering occurred.

The percentage of children under five years of age with growth retardation (i.e., “stunting” or reduced height growth) is an indicator of malnutrition. This measures the combination of inadequate diet and sickness (primarily the common childhood illnesses of diarrhoeal and respiratory infections). The prevalence of stunting had risen from around eighteen percent in southern/central Iraq in 1991 to more than thirty percent in 1996. This increase in child malnutrition (rapid in comparison with the changes usually seen) is attributed to the effects of war damage and sanctions on health environment and food availability. It is reasonable to assume that, without the Programme, the prevalence would have stayed high or continued to rise. By

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1999, after two years or so of the Programme, the prevalence had fallen back close to that of 1991 (about twenty-two percent). This reduction in prevalence can probably be attributed to the Programme, and indeed is one of the clearest positive impacts of the Programme. In terms of numbers, it can be estimated, for example, that there were some 360,000 fewer malnourished children in 2000 than there otherwise would have been.

In the three northern governorates, child nutrition was initially worse, with stunting estimated at around thirty percent in 1991. Malnutrition prevalences fell in the period 1991-1996, then faster in 1996-2002. The latter acceleration is also likely to be due to additional resources and program activities supported by the Programme.

Health impacts are problematic to assess because of lack of comparable data. Immunization rates for children were maintained during the 1990s, despite all the difficulties, and the Programme contributed to sustaining the coverage. Because of damage to sewage disposal and water purification plants, diarrhoeal disease was a major problem. Reports are in line with increases in 1991 in some cases (e.g., giardiasis) and in 1994-1995 in other cases (e.g., amoebic dysentery), as the situation deteriorated further. But then there was a reduction in dysentery in 1996-1998, possibly due to improvements supported by the Programme. Reported incidences rose again in 1999-2001, probably due to the drought and the much-reduced (and contaminated) water supplies.

Perhaps surprisingly, conclusions on mortality in relation to the Programme cannot be reached. The data on mortality are the least consistent (only children under five years old were considered, for whom there are more data than for other ages). A new realization (for the Working Group) was that the child mortality rates by 1990 had remained high (about 85/1,000 live births) in Iraq during the 1980s (while declining almost everywhere else), so that by the 1990s the underlying rate—even without war and sanctions—is expected to have been at this level. This affects estimates of the “excess mortality” rates in the 1990s. On balance, the total additional child deaths (above the pre-1991-war rate) during 1991-1995 are thought to be up to 68,000 deaths of children under five.

No estimates considered reliable of under-five mortality were found for the period of the Programme, and thus no estimates of lives possibly saved by the Programme can be made. The likelihood of reduced mortality is indicated by the improvement in child nutrition and from the increased availability (although still inadequate) of medicines.

## B. NEGATIVE ASPECTS

The short-term approach of the Programme, essentially as a relief operation, led to many missed opportunities for greater impact and indeed to some actual harm.

A more effective humanitarian approach would have aimed to restore productive capacity, repair infrastructure, generate employment, and use the extensive capabilities of the Iraqi people to support their own livelihood. The basis for the “relief” approach was presumably at first the perceived urgency of the deteriorating situation—food had to be supplied—but the opportunity to move towards support to livelihood was not taken, for reasons such as the policy of reducing the

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Government of Iraq's access to hard currency. While it is well recognized, in principle, that relief operations efforts are needed to move from handouts to employment and local production—and this does not need stressing from the Iraq experience—nonetheless, the results in Iraq from 1996 to 2003 do provide an example of the ineffectiveness of long-drawn-out relief: investment in people undoubtedly would have reduced deprivation more effectively, and with more dignity.

The centralized distribution operation in southern and central Iraq shifted more control into the hands of the central government. It is widely reported that, in practice, the effect of consigning control of the resources needed for people to stay alive (food rations) to a regime as intent on controlling its population as the Government of Iraq was, leads predictably to increasing the degree of control; this in turn had negative effects on the population's well-being, not least for nutrition and health.

The “relief” approach led to low priority for repairing infrastructure needed to protect health—even for repairs for which there was no arguable “dual use” constraint. However, the Programme's failure to do more to repair infrastructure was indeed constrained by the “holds” imposed by the 661 Committee as well as other obstructions. It appears that the Programme was somewhat unresponsive to evolving needs deriving from possible changing disease patterns, at least in terms of equipment. For example, by 2000, WHO was formally highlighting reports of increases in cancers and birth defects and the absence of medicines and equipment to deal with these illnesses.

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# MANAGEMENT OF THE OIL-FOR-FOOD PROGRAMME

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### SOURCES AND AMOUNTS OF ILLICIT INCOME TO IRAQ

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## I. INTRODUCTION AND SUMMARY

The value of the illicit revenues collected by the former Iraqi regime during the Programme has been a subject of considerable interest and speculation in recent years. In addition to figures appearing in press and media sources, a number of formal estimates of the funds acquired by the Iraqi regime in contravention of Security Council resolutions have been put forward. As noted in the First Interim Report, these estimates vary considerably in their methodologies and quantitative conclusions.<sup>20</sup>

This Chapter sets out a comprehensive estimate of Iraq's illicit income during the sanctions period from 1990 to 2003 by drawing on a vast range of Iraqi records, banking documents, and interviews. Much of the information used to calculate this estimate has only recently come to light and therefore was not included in earlier estimates by other organizations. Nevertheless, the data assembled by the Committee is not complete and, in all respects, may be subject to additional refinement.<sup>21</sup>

In describing sources of illicit income, a key distinction exists between illicit income from transactions that occurred under the Programme (i.e., oil contract surcharges and humanitarian contract kickbacks) and illicit income from transactions that occurred outside the Programme (i.e., smuggling of oil and other goods in contravention of the sanctions regime). The distinction matters in part because of the difference in degree to which United Nations officials were on notice and positioned to redress these different schemes of the Iraqi regime to reap revenue outside the United Nations escrow account.

This Chapter addresses three questions:

1. How much income did Iraq derive from surcharges imposed on oil contracts and kickbacks imposed on humanitarian goods contracts?

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<sup>20</sup> "First Interim Report," pp. 41-42; Independent Inquiry Committee, "Comparison of Estimates of Illicit Iraqi Income During United Nations Sanctions," <http://www.iic-offp.org/documents/ComparisonofEstimates.pdf> (Feb. 3, 2005); Coalition for International Justice, "Sources of Revenue for Saddam and Sons" (Sept. 2002) (hereinafter "CIJ Report"); United States General Accounting Office, "Weapons of Mass Destruction: U.N. Confronts Significant Challenges in Implementing Sanctions against Iraq" (May 2002) (hereinafter "GAO Report"); Iraq Survey Group, "Comprehensive Report of the Special Advisor to the DCI on Iraq's WMD" (Sept. 30, 2004) (hereinafter "ISG Report"); United States Permanent Subcommittee on Investigations – Committee on Governmental Affairs, "Methodology for Estimate of Total Illicit Iraqi Income During UN Sanctions (1991-2003)" (Nov. 15, 2004) (hereinafter "Senate PIC Report").

<sup>21</sup> The Committee has obtained records from the Government of Iraq, including financial records, internal Iraqi Ministry correspondence and directives, side agreements and correspondence between Iraqi Ministries and companies, bank statements, and bank receipts (hereinafter referenced collectively as "Iraqi records").



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2. How much income did Iraq derive from oil sales outside of the Programme?
3. To what extent did Iraq manipulate the pricing of oil and other commodities under the Programme in order to facilitate the collection of illicit revenues?

The answers to these three questions reflect not only the extent of Iraq's manipulation of the Programme but also the consequences of the United Nations' inadequacy in enforcing its rules and the imposed economic sanctions.

Part II of this Chapter estimates the monetary value of the illicit fees collected by Iraq in connection with sales of oil and purchases of humanitarian goods and oil spare parts under the Programme. Part III calculates the amount of oil the Government of Iraq had at its disposal for smuggling and estimates the revenues generated by this illegal trade. Part IV examines the possibility of deliberate underpricing of oil and overpricing of goods sold under the Programme and evaluates the effects of this price manipulation in terms of lost revenue to the escrow account. Part V includes the Committee's estimate of total illicit income earned.

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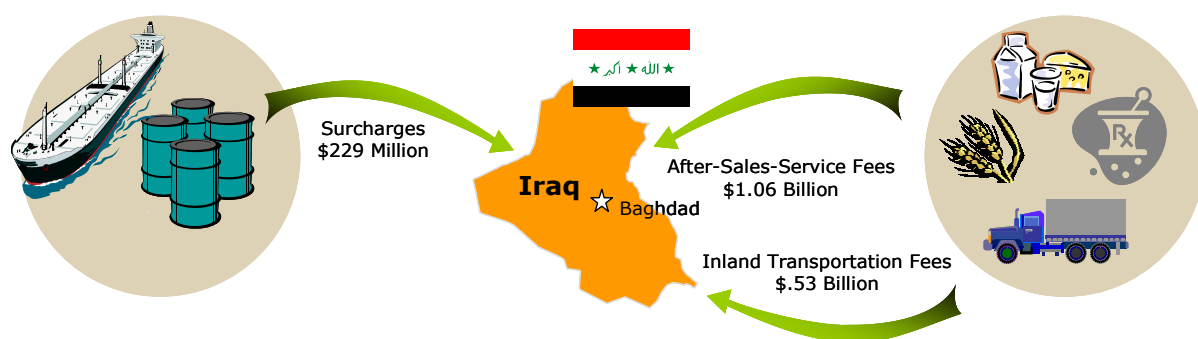
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## II. ILLICIT PAYMENTS ON PROGRAMME CONTRACTS

As depicted in Chart A, the Committee estimates that the total illicit income the Iraqi regime extracted under the Programme from oil buyers and humanitarian suppliers was \$1.8 billion. This figure reflects \$229 million in oil surcharges, \$1.06 billion in after-sales-service fees, and \$527 million in inland transportation fees paid to the Iraqi regime.

**Chart A – Illicit Income Received by Iraq under the Programme**



### A. ILLICIT INCOME FROM OIL SURCHARGES

The Committee estimates that the former Government of Iraq earned approximately \$229 million in surcharges on oil sold by Iraq under the Programme. As described in Chapter 1 of Volume II, surcharges were levied on a volumetric basis and ranged from ten to fifty cents per barrel. They commenced in the latter part of 2000 and ended in the fall of 2002 after the advent of “retroactive pricing” made the surcharge scheme less profitable for Iraq to pursue.<sup>22</sup>

<sup>22</sup> Iraq Ministry of Oil record, SOMO ledger of collection of surcharges from September 2000 to March 2003 (Aug. 23, 2004) (translated from Arabic) (hereinafter “SOMO surcharge records”); Independent Inquiry Committee, “Transactions and Relations System” (hereinafter “TaR”) (1996-2003); Iraq Ministry of Oil record, Shamkhi H. Faraj report to the Minister of Oil, “Allocations and Sales of Crude Oil in the phases of the Memorandum of Understanding 1996-2003,” pp. 3-4 (Feb. 19, 2004) (translated from Arabic) (including a summary by SOMO officials of Iraq’s oil allocation and sales practices during the Programme) (hereinafter “SOMO Summary Report”). TaR is an analytical database maintained by the Committee that contains information gathered in the course of its investigation, including data from the United Nations Treasury database of payments, the Office of the Iraq Programme (“OIP”) database of contracts, correspondence and data from Iraqi files, data from third-party sources such as Dun & Bradstreet and

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This figure of \$229 million is derived from three complementary sources: (1) internal SOMO documents that record levied and collected surcharges (“SOMO surcharge records”); (2) transaction histories of bank accounts used by SOMO to receive surcharge payments; and (3) Iraqi records of receipts for cash deposits made by oil companies at various Iraqi embassies in cities worldwide. In the first instance, the SOMO surcharge records comprehensively identify the amounts of surcharges levied and paid and the oil contracts for which surcharges were paid. The Committee has corroborated more than ninety-eight percent of these listed transactions by cross-reference to further bank account documentation and embassy receipt records. This data reflects that all but a small percentage of surcharges were paid to Iraqi bank accounts in neighboring countries (\$129 million to the Jordan National Bank in Amman and \$30 million to Fransabank in Lebanon) and to Iraq’s embassy in Moscow (more than \$52 million in cash).<sup>23</sup>

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Platts, correspondence and records from certain companies involved in the Programme, and records from selected banks. Section III.D of Chapter 3, in Volume II, details the advent of retroactive pricing.

<sup>23</sup> SOMO surcharge records; Iraq Ministry of Oil record, receipts of payments collected by Iraqi embassies (Mar. 2001 to Dec. 2002) (translated from Arabic); Iraq Ministry of Oil record, Iraqi accounts at Jordan National Bank, bank advices and statements (Oct. 2000 to Mar. 2003) (translated from Arabic); Iraq Ministry of Oil record, Iraqi accounts at Fransabank, bank advices and statements (Sept. 2000 to July 2004) (translated from French and Arabic); Jordan National Bank record, Iraqi accounts, bank advices, statements and correspondences (Oct. 2000 to Mar. 2003) (translated from Arabic); Fransabank record, Iraqi accounts, bank advices, statements and correspondences (Sept. 2000 to Aug. 2002) (translated from French and Arabic); Company record, correspondences and bank advices (Dec. 2000 to Sept. 2001) (translated from Arabic); TaR (1996-2003).

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Table 1 – Confirmed and Unconfirmed Deposits of Surcharges (in USD millions)<sup>24</sup>

	Total	% of Total
Embassies and representative offices of Iraq		
Ankara, Turkey	\$ 1.1	0.5%
Athens, Greece	0.7	0.3%
Cairo, Egypt	0.2	0.1%
Damascus, Syria	1.2	0.5%
Geneva, Switzerland	0.7	0.3%
Hanoi, Vietnam	3.0	1.3%
Kuala Lumpur, Malaysia	0.9	0.4%
Moscow, Russia	52.8	23.1%
Rome, Italy	0.1	0.0%
Sana'a, Yemen	0.5	0.2%
Vienna, Austria	0.1	0.1%
<i>Sum of deposits via embassies and representative offices of Iraq</i>	<i>61.3</i>	<i>26.8%</i>
Jordan National Bank, Jordan	128.8	56.3%
Fransabank, Lebanon	29.8	13.0%
Company records	6.0	2.6%
<b>Surcharges confirmed</b>	<b>225.9</b>	<b>98.7%</b>
Unconfirmed surcharges	2.9	1.3%
<b>Total surcharges paid</b>	<b>\$ 228.8</b>	<b>100.0%</b>

SOMO levied more in surcharges than it was eventually paid. SOMO surcharge records, banking data, and embassy records reflect that 919 individual surcharges valued at \$263 million were levied on 169 companies that contracted for the purchase of oil. Of these 169 companies, 138 ultimately made payments in connection with 309 contracts. The remaining thirty-one companies succeeded in lifting oil without remitting funds to Iraq. Ninety of the companies that lifted oil paid surcharges only in part rather than the full amount levied. A few companies were less

<sup>24</sup> SOMO surcharge records; Iraq Ministry of Oil record, receipts of payments collected by Iraqi embassies (Mar. 2001 to Dec. 2002) (translated from Arabic); Iraq Ministry of Oil record, Iraqi accounts at Jordan National Bank, bank advices and statements (Oct. 2000 to Mar. 2003) (translated from Arabic); Iraq Ministry of Oil record, Iraqi accounts at Fransabank, bank advices and statements (Sept. 2000 to July 2004) (translated from French and Arabic); Jordan National Bank record, Iraqi accounts, bank advices, statements and correspondences (Oct. 2000 to Mar. 2003) (translated from Arabic); Fransabank record, Iraqi accounts, bank advices, statements and correspondences (Sept. 2000 to Aug. 2002) (translated from French and Arabic); Company record, correspondences and bank advices (Dec. 2000 to Sept. 2001) (translated from Arabic); TaR (1996-2003).

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fortunate, however, and paid surcharges of \$588,800 on contracts that were never executed. The net amount of underpayment—i.e., the difference between the total surcharges levied (\$263 million) on executed contracts and total surcharges received on both executed and unexecuted contracts (\$229 million)—was \$34 million.<sup>25</sup>

The Committee's final report will examine at length some of the individual companies that made surcharge payments as well as the structure of underlying purchase deals, financing arrangements, and payment arrangements.

### B. ILLICIT INCOME FROM HUMANITARIAN CONTRACT KICKBACKS

The Iraqi regime derived far more illicit income from kickbacks on humanitarian contracts (including contracts for oil spare parts) under the Programme than from oil surcharges. The Committee estimates that the former Iraqi regime received approximately \$1.6 billion in illicit income by requiring suppliers to pay fees—all outside the United Nations escrow account—in connection with their sales of goods to Iraq under the Programme.

As described in more detail in Chapter 1 of Volume II of this Report, these fees included: (1) mandatory “after-sales-service” fees, usually in the amount of ten percent of contract values negotiated between the supplier and Iraq prior to the submission of a contract for approval by the United Nations; and (2) “transportation” fees levied on the basis of the volume, weight or quantity of goods imported into Iraq at its port of Umm Qasr. Both “after-sales-service” fees and “transportation” fees are misleading terms for these forms of kickbacks, inasmuch as they imply that the levied fees corresponded to actual costs incurred by the Government of Iraq. In reality, an after-sales-service fee was merely a euphemism for “kickback” devised by the Iraqi regime; it did not actually relate to the performance of any services. Likewise, the cost of transporting goods inside Iraq was far less than the amounts demanded of suppliers. In any event, all such kickbacks were paid by suppliers to Iraq outside the United Nations escrow account.<sup>26</sup>

The Committee's estimate of illicit income associated with humanitarian contracts draws upon the following evidence:

- United Nations accounting records detailing the actual amounts spent on humanitarian contracts during the course of the Programme;

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<sup>25</sup> SOMO surcharge records (2000-2002); TaR (1996-2003).

<sup>26</sup> Iraq Ministry of Oil record, Taha Yassin Ramadan memorandum to Iraqi Ministries (Aug. 3, 2000) (translated from Arabic) (instructing Iraqi Ministries to impose kickbacks under the moniker “After-Sales-Service”); Iraq officials interviews. Figures in this Chapter are reported at the summary level and not by company.

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- Extensive Iraqi records detailing the policies put in place by the former regime regarding illicit income, including policies relating to transportation fees;
- Accounting records and data from a number of Iraqi ministries that detail levied and collected kickbacks; and
- Banking records confirming and quantifying the deposit of kickbacks into collection accounts.<sup>27</sup>

Subsection II.B.1 reviews Iraq's revenue from the after-sales-service fees, and Subsection II.B.2 reviews Iraq's revenue from transportation fees.

#### 1. Revenue from After-Sales-Service Fees

The Committee estimates that the Iraqi regime collected nearly \$1.06 billion from after-sales-service fees that it levied in connection with humanitarian contracts under the Programme. This estimate is based on: (1) financial summaries compiled by various Government of Iraq ministries that bought goods under the Programme; (2) confidential directives and policy documents issued by high-level Iraqi bodies; (3) a collection of more than 1,600 "side agreements" (i.e., contracts between a company and an Iraqi ministry to pay a kickback outside of the escrow account); and (4) numerous interviews with Iraqi officials and goods suppliers.<sup>28</sup>

Unlike the oil surcharge scheme—which was overseen principally by SOMO—the collection of after-sales-service fees involved numerous Iraqi ministries and government organs, many of which have not retained detailed records of their received kickbacks. Despite these difficulties, the Committee has obtained records reflecting payments of nearly \$200 million in after-sales-service fees by contractors under the Programme. In addition, the Committee has identified extensive documentation pertaining to *levied* after-sales-service fees. This second group of records does not indicate which fees were ultimately collected.<sup>29</sup>

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<sup>27</sup> TaR (1996-2005); Iraqi records; Ministry of Oil record, Taha Yassin Ramadan memorandum to Iraqi Ministries (Aug. 3, 2000) (translated from Arabic); Iraq officials interviews; Rafidain Bank record, Iraqi State Company for Water Transportation bank accounts and statements (1999-2003) (translated from Arabic).

<sup>28</sup> Iraqi records (1996-2005); TaR (1996-2005). The Committee collected data on kickbacks levied on more than 6,500 contracts and kickbacks paid on more than 2,500 contracts. The contracts were executed by thirteen Iraqi Ministries and entities including: Agriculture, Education, Electricity, Health, Housing, Industry, Interior, Municipality of Baghdad, Oil, Trade, Transportation, and Youth. The \$1.06 billion in collected after-sales-service fees is consistent with the estimated amount provided by Iraqi officials involved in the collection of these fees. Iraq officials interviews.

<sup>29</sup> *Ibid.*; TaR (1996-2005).

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In view of the incomplete nature of evidence on after-sales-service fees, the Committee drew on records of actual payments of fees and applied that information to contracts for which the Committee does not have specific kickback data. In doing so, the Committee used a six-step process:

1. Determined which contracts were subject to after-sales-service fees (referred to as the “Population” for the purposes of this analysis);
2. Identified contracts within the Population for which the Committee had contract-specific evidence from an Iraqi ministry of the levying or collection of an after-sales-service fee;
3. Used the known after-sales-service fees to estimate the rate (in terms of a percentage of contract values) of the fees levied on the contracts for which the Committee does not have specific evidence;
4. Applied the rate described in Step 3 to the contracts not identified in Step 2 and calculated the total levied after-sales-service fees;
5. Estimated the ratio of after-sales-service fees levied to after-sales-service fees collected; and
6. Applied the ratio described in Step 5 to the total levied after-sales-service fees calculated in Step 4.

The “Population” noted in Step 1 refers to contracts executed after August 2000 that resulted in the delivery of goods prior to July 2003. This constraint encompasses the point when after-sales-service fees were first levied and the date when CPA effectively announced the end of this scheme in conjunction with renegotiating contracts after the war. Of the 18,458 contracts funded out of the ESB Account (also known as the fifty-nine percent account for humanitarian goods for southern and central Iraq), 6,786 contracts valued at \$13.8 billion fall within the parameters of the Population.<sup>30</sup>

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<sup>30</sup> Iraq Ministry of Oil Record, Taha Yassin Ramadan memorandum to Iraqi Ministries (Aug. 3, 2000) (translated from Arabic); CPA note verbale to Kofi Annan (July 5, 2003); TaR (1998-2005). Most contracts for goods delivered subsequent to July 2003 were not included in the Population on the assumption that any kickbacks they might have contained were eliminated by CPA. However, ninety-five contracts—seven in 2003, eighty-two in 2004, and six in 2005—for which the Committee has specific evidence relating to kickback payments were included in the Population. TaR (2003-2005). On the other hand, certain types of contracts were not included in the Population. First, Iraqi records reflect the payment of approximately \$15 million in after-sales-service fees on contracts that were executed prior to the formal initiation of Iraq’s kickback policy in August 2000. Because of the date limitation, these pre-kickback-

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With regard to Step 2, the Committee has identified \$552.65 million in after-sales-service fees levied on 3,499 contracts. These contracts have a total value of \$5.9 billion. The Committee does not have specific kickback information on the remaining 3,287 contracts in the Population, valued at \$7.9 billion.

The rate described in Step 3 was calculated by taking a weighted average of identified after-sales-service fees for *all* contracts for which the Committee had data—i.e., the 3,499 contracts noted above as well as 863 contracts that fall outside the Population. This weighted average equaled 10.21 percent of contract values, indicating that the Iraqi regime in some instances chose to levy after-sales-service fees at rates higher than ten percent.<sup>31</sup>

Step 4 involves the multiplication of this weighted average of 10.21 percent times \$7.9 billion, the value of the contracts in the Population for which no specific after-sales-service data were accumulated by the Committee. The result of this tabulation is \$731.6 million. Adding this amount to the \$552.65 million in known after-sales-service fees yields an estimated \$1.3 billion in total levied fees.<sup>32</sup>

With regard to Step 5, the Committee analyzed records showing actual payments of kickbacks and calculated a recovery rate that represents the average amount of the levied fee that the regime in fact collected. The sum of actual kickback payments was divided by its corresponding levied amount, yielding a recovery rate of 84.25 percent. This recovery rate was applied to the actual and estimated levied amounts for all remaining contracts for which no actual payment data was available. As illustrated in Table 2, this produced a total of \$1.056 billion in estimated payments: \$198 million actual and \$858 million estimated.<sup>33</sup>

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policy contracts were not included in the Population, and the most likely explanation for this aberrant data resides in the fact that all of the goods procured under the contracts in question arrived in Iraq *after* August 2000. Second, there were 5,355 contracts executed prior to Phase VIII with goods delivered after July 2003. Since the Committee only had specific information regarding kickbacks paid for 156 of these contracts, it considered that these were exceptions and did not extend the Population to project levied and collected amounts on the remaining 5,199 contracts. *Ibid.* (1998-2005).

<sup>31</sup> *Ibid.* (1996-2005). The 863 contracts that fell outside of the Population are largely contracts where the goods were delivered after July 2003.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.* In addition, Iraqi records also note \$13 million in fees (shown in Table 3 under the classification “various”) paid in connection with contracts that appear not to have been forwarded to the United Nations. These payments suggest that, as was the case with oil surcharges, in some instances after-sales-service fees were collected on unexecuted contracts.



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Table 2 – Estimated After-Sales-Service Fees Paid (in USD millions)<sup>34</sup>

Phase	Evidence of After-Sales-Service Fees Paid	Projected After-Sales-Service Fees Paid	Total Estimated After-Sales-Service Fees Paid
1	N/A	N/A	N/A
2	N/A	N/A	N/A
3	N/A	N/A	N/A
4	N/A	N/A	N/A
5	\$0.12	N/A	\$0.12
6	5.68	N/A	5.68
7	8.89	N/A	8.89
8	68.55	\$249.28	317.83
9	50.46	208.69	259.15
10	32.40	194.25	226.65
11	13.49	136.97	150.46
12	4.76	56.46	61.21
13	0.13	12.62	12.75
Various	13.17	-	13.17
<b>Total</b>	<b>\$197.65</b>	<b>\$858.26</b>	<b>\$1,055.91</b>

The Committee's final report will examine some individual companies at length and will report in detail on the companies known to have paid after-sales-service fees.

## 2. Inland Transportation Fees

On the basis of high-level Iraqi directives, detailed records reflecting transportation fees collected on a large number of contracts, summary memoranda prepared by Ministry of Transportation officials and banking data, the Committee estimates that the Iraqi regime collected \$527 million in inland transportation fees between June 1999 and July 2003.<sup>35</sup>

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<sup>34</sup> Ibid.

<sup>35</sup> Ibid.; Ministry of Transportation and Communication record, Iraqi Minister of Transport letter to Iraqi Minister of Finance (Mar. 11, 2003) (translated from Arabic); Rafidain Bank record, Iraqi State Company for Water Transportation bank accounts and statements (1999-2003) (translated from Arabic); Iraq official interview.

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Three documents are especially significant to this estimation: (1) a document dated March 11, 2003 and prepared by the Ministry of Transportation for the Deputy Prime Minister and the Minister of Finance stating that the Iraq State Company for Water Transport (“ISCWT”), a government body that oversaw activities at all Iraqi ports, had collected \$651 million in after-sales-service and transportation fees since June 1999; (2) a summary analysis of the total funds transferred out of ISCWT’s accounts at Rafidain Bank to the Central Bank of Iraq between December 31, 2002 and February 28, 2003; and (3) the transaction histories of ISCWT’s accounts at Rafidain Bank.<sup>36</sup>

The Rafidain Bank accounts reflect that ISCWT received \$919 million in kickbacks between 1999 and 2003, but do not specify what percentage of these funds was derived from transportation fees. By contrast, the Ministry of Transportation document and the Rafidain Bank summary analysis distinguish between after-sales-service fees and transportation fees, but they do not appear to reflect the totality of the funds that ISCWT collected. In tabulating the figure of \$527 million, the Committee made use of complementary information by applying the ratio of after-sales-service fees to transportation fees noted in the first two documents to the \$919 million recorded in the account statements.<sup>37</sup>

### 3. Other Fees

Certain types of fees have not been included in the Committee’s estimate of humanitarian-kickback-related revenues because systematic evidence of the use of these fees across ministries and contracts could not be identified. For example, one Iraqi ministry appears to have assessed “tender fees,” averaging 0.3 percent of contract values, in addition to after-sales-service fees and inland transportation fees. It is unclear when and why tender fees were first imposed or if they were collected by other ministries.<sup>38</sup>

Also not included in the Committee’s estimate are several types of fees or costs included in earlier estimates and summarized in its First Interim Report for which the Committee’s further investigation has not found adequate evidence. Some estimates assume, for example, that the Iraqi regime derived illicit revenues by procuring substandard goods. The Committee understands that there is some anecdotal evidence for this hypothesis and that spoilage occurred

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<sup>36</sup> TaR (1996-2005); Ministry of Transportation and Communication record, Iraqi Minister of Transport letter to Iraqi Minister of Finance (Mar. 11, 2003) (translated from Arabic); Rafidain Bank record, Iraqi State Company for Water Transportation bank accounts and statements (1999-2003) (translated from Arabic); Iraq official interview.

<sup>37</sup> TaR (1996-2005).

<sup>38</sup> Ibid. (2000-2003). Of the 1,620 side letters collected by the Committee, 339 letters mentioned the vendor’s obligation to pay “tender charges” that amounted on average to 0.3 percent of the contract value. See, e.g., Ministry of Trade record, Side agreements for COMM nos. 1101935, 1201802.

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and out-of-date goods were delivered. Despite these reports, the Committee has not identified any evidence in the form of Iraqi documents or statements made by Iraqi officials that an organized scheme existed to procure goods of inferior quality. Nor has the Committee obtained corroborative evidence that purchasing any substandard goods resulted in a pecuniary benefit to the Iraqi regime.<sup>39</sup>

Finally, some earlier estimates of Iraq's illicit income overbroadly assumed that there were kickbacks or other forms of illicit payments collected in connection with purchases of goods from monies in the ESC Account (13 percent Account) by the Agencies operating in the three northern governorates of Iraq. The Committee has not found any evidence suggesting that the Iraqi regime derived funds from such practices. In fact, such collections are highly improbable given that all but the bulk goods and spare parts purchased out of the ESC Account were procured under contracts between the Agencies and individual suppliers. The Iraqi regime had no role in the negotiations or executions of these contracts.<sup>40</sup>

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<sup>39</sup> "First Interim Report," pp. 41-42; Senate PIC Report; Tun Myat interview (July 28, 2005); Frances Kinnon interview (Dec. 15, 2004); Ahmed Murtada Ahmed Al-Khalil interview (Nov. 5, 2005); Iraq officials interviews. Mr. Myat served as Humanitarian Coordinator, United Nations Office of the Humanitarian Coordinator for Iraq, from 2000 to 2002. Ms. Kinnon served as a Political Analyst within OIP. Mr. Al-Khalil served as Iraqi Minister of Transport. Tun Myat interview (July 28, 2005); Ahmed Murtada Ahmed Al-Khalil interview (Nov. 5, 2005).

<sup>40</sup> Senate PIC Report, p. 4. For a detailed discussion of the Agencies' roles in administering the Programme, see Chapter 4 of Volume IV.

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## III. ILLICIT INCOME FROM SMUGGLING

As described in Chapter 4 of Volume II, Iraq sold oil to neighboring countries and private entities during the entire sanctions period. This trade, often described as smuggling, included sales based on formal arrangements, such as protocols with the governments of Jordan, Syria, Turkey, and Egypt, as well as informal, smaller scale arrangements, such as selling crude oil and refined products in smaller lots to private parties.<sup>41</sup>

The Committee estimates that the value of oil and oil products sold outside the sanctions regime from 1991 to 2003 was about \$11 billion, of which approximately \$8.4 billion was during the years of the Programme between 1997 and 2003. The calculations behind this estimate are described below.

### A. VOLUME OF OIL AVAILABLE FOR SMUGGLING

The Ministry of Oil has provided the Committee with data concerning Iraq's production, internal consumption, and foreign trade of oil. Based on this information, the Committee estimates the amount of oil Iraq produced, used, and made available for trade in the years prior to and during the Programme. As reflected in Table 3 below, Iraq produced more than 7.3 billion barrels of oil between 1991 and 2003. Of this total volume, nearly 1.5 billion barrels were consumed internally, about 1.6 billion barrels were re-injected into the ground for later use, and more than 3.4 billion barrels were sold under the Programme. Based on these figures, it appears that just over twelve percent, or 858 million barrels, of Iraq's oil production during the sanctions period was available for smuggling. Of these 858 million barrels, about 642 million were smuggled out of Iraq during the Programme.<sup>42</sup>

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<sup>41</sup> Smuggling is reviewed in Chapter 4 of Volume II.

<sup>42</sup> Iraq Ministry of Oil record, "Oil production & internal consumption of crude," "Domestic consumption of refined petroleum products," and "Total oil production" (providing various Iraqi oil statistics for 1991 to 2003) (hereinafter "Ministry of Oil Production Tables"); United States official #24 interview (Sept. 1, 2005). The Committee's summary in Table 3 is based on Ministry of Oil Production Tables. The information on amounts of oil re-injected for later use was provided by a former CPA employee who is highly familiar with the activities of Iraq's Ministry of Oil. As discussed in Chapter 4 of Volume II, Iraq's major border trading partners—Jordan, Turkey, and Syria—declined to furnish information concerning their trade with Iraq, other than to confirm that trade protocols with Iraq existed, notwithstanding the United Nations sanctions regime. Internal consumption is the total domestic consumption of fuel oil, gasoline, benzene, and light gas in addition to power used to produce the crude. "Re-injection" refers to the process whereby oil is returned to reservoirs.

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Table 3 – Iraqi Oil Available for Smuggling (in millions of barrels)<sup>43</sup>

Year	Total Production	Internal Consumption	Re-Injection of Crude & Fuel Oil	Oil Sold Under the Programme	Total Oil Available for Smuggling
<i>Prior to the Programme</i>					
1991	191.38	86.61	87.31	-	17.46
1992	385.06	112.00	237.42	-	35.64
1993	370.55	110.19	235.69	-	24.67
1994	377.01	104.54	237.84	-	34.63
1995	387.63	107.68	253.98	-	25.97
1996	420.22	104.37	238.34	-	77.51
<i>Sub-total</i>	<i>2,131.85</i>	<i>625.41</i>	<i>1,290.57</i>	<i>-</i>	<i>215.87</i>
<i>During the Programme</i>					
1997	546.64	115.15	145.59	246.46	39.44
1998	791.58	121.75	70.64	545.75	53.45
1999	927.62	124.25	7.78	728.16	67.43
2000	952.05	132.59	10.71	703.58	105.17
2001	943.76	149.59	23.93	619.61	150.63
2002	812.80	171.34	28.36	461.50	151.59
2003	226.18	17.46	8.50	125.66	74.56
<i>Sub-total</i>	<i>5,200.63</i>	<i>832.13</i>	<i>295.51</i>	<i>3,430.72</i>	<i>642.27</i>
<b>Total</b>	<b>7,332.48</b>	<b>1,457.55</b>	<b>1,586.07</b>	<b>3,430.72</b>	<b>858.14</b>

## B. ESTIMATED INCOME FROM OIL SMUGGLED

SOMO has provided the Committee with summary sales data on oil and oil products sold outside and prior to the Programme. As illustrated in Table 4 below, oil was sold under protocols with neighboring states and through “border trade” with private parties. Prior to the Programme, Iraq sold a total of \$2.6 billion in oil and oil products exclusively to Jordan in exchange for cash, goods, or reduction of debt. During the Programme, Iraq’s smuggling grew to encompass trade

<sup>43</sup> Ministry of Oil Production Tables; United States official #24 interview (Sept. 1, 2005). The Programme commenced on December 10, 1996, and 9.66 million barrels were sold between this date and January 1, 1997. For simplicity of analysis, these barrels have been categorized as sales during the Programme. TaR (Dec. 10, 1996 to Jan. 1, 1997).

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protocols principally with Turkey, Syria, and Egypt. Accordingly, between 1997 and 2003, annual smuggling rates more than tripled, resulting in total sales of about \$8.4 billion worth of oil and oil products during these years. This increase is largely attributable to the reactivation of the Syrian pipeline in 2000, which is discussed at length in Chapter 4 of Volume II of this Report.<sup>44</sup>

**Table 4 – Value of Oil and Oil Products Sold Outside of the Programme, 1991 through March 2003 (in USD millions)<sup>45</sup>**

Year	Protocols					Border Trade	Total	Actual Cash Received
	Jordan	Syria	Turkey	Egypt	Total			
	A	B	C	D	E=A+B+C+D	F	G= E+F	
1991	\$ 333.51	\$ -	\$ -	\$ -	\$ 333.51	\$ -	\$ 333.51	\$ 157.51
1992	472.37	-	-	-	472.37	-	472.37	253.37
1993	405.11	-	-	-	405.11	-	405.11	224.11
1994	377.69	-	-	-	377.69	-	377.69	196.69
1995	423.26	-	-	-	423.26	-	423.26	220.26
1996	587.87	-	-	-	587.87	-	587.87	257.87
<b>Sub-total</b>	<b>\$ 2,599.81</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,599.81</b>	<b>\$ -</b>	<b>\$ 2,599.81</b>	<b>\$ 1,309.81</b>
1997	\$ 653.06	\$ -	\$ -	\$ -	\$ 653.06	\$ 11.84	\$ 664.90	\$ 403.06
1998	331.85	-	-	-	331.85	16.70	348.55	82.85
1999	420.20	-	-	-	420.20	236.86	657.06	216.20
2000	687.16	197.30	98.29	-	982.75	396.32	1,379.07	505.40
2001	509.63	1,131.02	281.58	5.74	1,927.97	183.11	2,111.08	776.97
2002	623.35	1,350.01	373.41	39.02	2,385.79	98.68	2,484.47	1,028.31
2003	151.30	453.74	53.37	-	658.41	86.87	745.28	225.85
<b>Sub-total</b>	<b>\$ 3,376.55</b>	<b>\$ 3,132.07</b>	<b>\$ 806.65</b>	<b>\$ 44.76</b>	<b>\$ 7,360.03</b>	<b>\$ 1,030.38</b>	<b>\$ 8,390.41</b>	<b>\$ 3,238.64</b>
<b>Total</b>	<b>\$ 5,976.36</b>	<b>\$ 3,132.07</b>	<b>\$ 806.65</b>	<b>\$ 44.76</b>	<b>\$ 9,959.84</b>	<b>\$ 1,030.38</b>	<b>\$ 10,990.22</b>	<b>\$ 4,548.45</b>

In total, smuggling generated nearly \$11 billion in illicit revenues for the Iraqi regime. Of this \$11 billion, more than \$4.5 billion was paid in cash and the equivalent of approximately \$6.5 billion was largely paid in goods although some portion might be still owed to Iraq.<sup>46</sup>

<sup>44</sup> Iraq Ministry of Oil record, SOMO tables, “Value of Iraqi Oil and Oil Products Sales Outside of ‘MOU’ from 1991 – April 2003” (Aug. 30, 2005) (attached to SOMO letter to the Committee (Aug. 30, 2005)) (hereinafter “SOMO Table on Oil Sales Outside of MOU”); SOMO record, Jordan, Syrian, Turkey, Egypt and border trade invoices and payments.

<sup>45</sup> SOMO Table on Oil Sales Outside of MOU.

<sup>46</sup> Ibid.

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## IV. THE IMPACT OF DISTORTED PRICES

In addition to estimating the illicit income acquired by the Iraqi regime during and prior to the Programme, this Chapter examines how Iraq's pricing of commodities under the Programme facilitated the collection of surcharges and kickbacks. Iraq's efforts to sell oil and purchase goods at prices inconsistent with market values are one measure of the costs the regime was willing to pay in its pursuit of illicit income. While the Committee is not able to quantify the extent of price distortions, the impact is clear—a direct loss of funds to the escrow account.

### A. UNDERPRICING OF OIL SOLD UNDER THE PROGRAMME

Even if Iraq had not chosen to systematically underprice its oil, it is likely that oil prices under the Programme would still have been low in comparison with market rates. At the outset of the Programme, prices were likely set low in order to attract participation in a newly revived Iraqi oil market. In addition, even after the Programme was underway, the market was irregular and unpredictable in that it operated on 180-day approvals by the Security Council. Finally, the quality of Iraqi crude oil purportedly declined between 1996 and 2003, which would have resulted in a corresponding decrease in value. For these reasons, Iraqi oil sold during the Programme was, to some extent, discounted.<sup>47</sup>

However, there is considerable reason to believe that Iraq did underprice its oil. In 2001, the United Nations oil overseers concluded that Iraq was setting prices lower than necessary to create a margin that the oil purchasers could use to pay surcharges. Indeed, the oil overseers highlighted consistent underpricing of Iraqi oil's official selling price relative to the end-user price, a discrepancy that the oil overseers called "excessive premia." Furthermore, a comparison of Programme prices of Basrah Light crude destined for the North American market with the market rate for MARS (a crude with a chemical consistency and trade value similar to that of Basrah Light crude) reveals that Programme prices were consistently lower than the market prices—in some instances by very large margins. Chart B compares Basrah Light priced for the North American market, the lower series of data points, to MARS prices, the upper series of data points. The critical period in which surcharges were in effect, September 2000 through August 2002, is denoted by shading.<sup>48</sup>

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<sup>47</sup> SOMO Summary Report; Chang-Tai Hsieh and Enrico Moretti, "Did Iraq Cheat the United Nations? Underpricing, Bribes, and the Oil for Food Program," *National Bureau of Economic Research Working Paper Series, Working Paper 11202*, Mar. 2005, pp. 3-4.

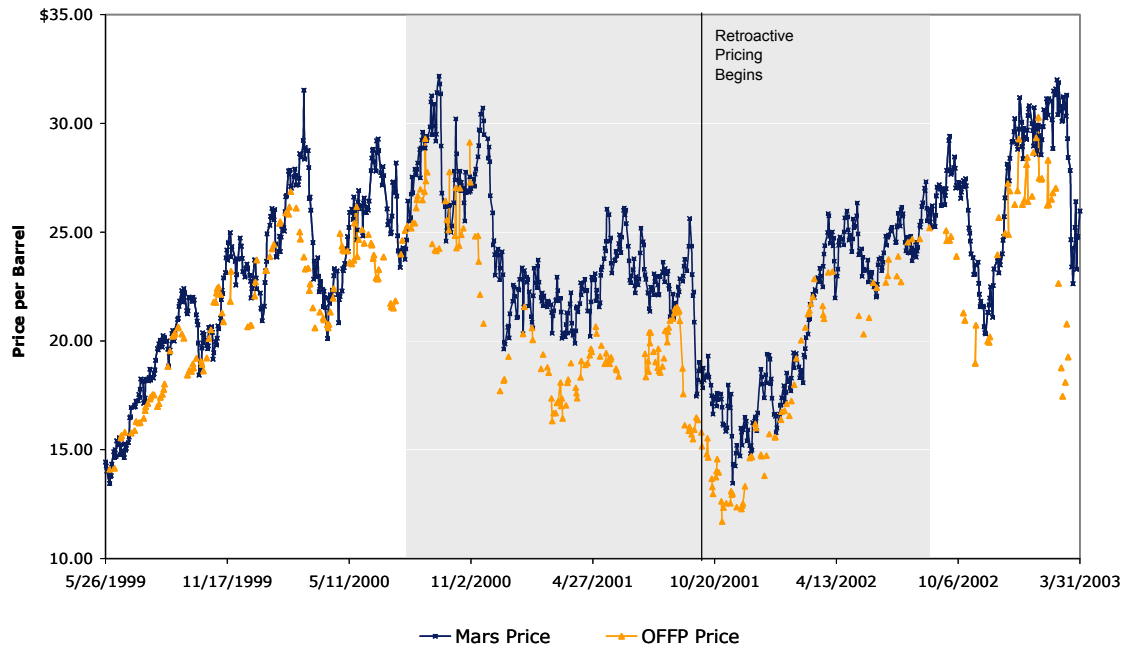
<sup>48</sup> Oil overseers letter to 661 Committee Chairman (Feb. 13, 2001) (signed by Michel Tellings, Morten Buur-Jensen, and Alexandre Kramar); Morten Buur-Jensen interview (Aug. 12, 2005). For a discussion of the overseers' concerns in light of Iraq's surcharge policy, see Chapter 3 of Volume II. *Platts*, MARS spot prices (May 26, 1999 to Mar. 31, 2003). MARS is used for this comparison because it is a crude similar to

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Chart B – Price per Barrel Comparison of MARS to Programme Basrah Light Sold in North America<sup>49</sup>



As illustrated in Chart B, the gap between MARS and Basrah Light prices widened significantly during the surcharge period, especially in the months between November 2000 and November 2001. In April 2001, for example, the difference between MARS and Basrah Light prices exceeded \$4 per barrel. Following the imposition of retroactive pricing, the difference between these two prices narrowed to as little as \$1-2 per barrel.<sup>50</sup>

Adjusting prices to permit the payment of a surcharge would have required relatively little underpricing—the \$229 million paid in surcharges is less than one percent of the total oil sales during the period when surcharges were being imposed. However, the other manipulations of the Programme that Iraq pursued through its oil sales necessitated further downward revisions. In

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Basrah Light, and it is produced in the Western Caribbean, reducing the impact of pricing issues associated with transportation delays and costs. Hence, its price is largely independent of transportation costs for sales to the North American market.

<sup>49</sup> *Platts*, MARS spot prices (May 26, 1999 to Mar. 31, 2003); TaR (1996-2003). “Actual Programme Price” is the average daily price of Basrah Light crude destined for North American and Caribbean ports.

<sup>50</sup> *Platts*, MARS spot prices (May 26, 1999 to Mar. 31, 2003); TaR (1996-2003).



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particular, the prices below market value facilitated the Iraqi regime's effort to gain influence and support from government figures, journalists, and others through its oil allocation scheme. The prices proposed by SOMO allowed recipients of oil allocations to obtain a profit when their allocations were sold on the market. The additional underpricing required by Iraq to implement its oil-for-influence scheme was approximately \$130.3 million. This is based on an assumption of an average commission of \$.10 per barrel paid to allocation holders for their right to purchase around 1.3 billion barrels of oil.<sup>51</sup>

However, this figure does not in and of itself justify the magnitude of Iraq's underpricing of its oil. In all likelihood, the majority of Iraq's underpricing was intended to facilitate the involvement of oil trading firms in the Programme, which by definition needed a significant price differential in order to resell oil to third-parties and retain a profit.<sup>52</sup>

## B. UNDERPRICING OF OIL SOLD OUTSIDE OF THE PROGRAMME

It is clear that oil smuggled during the Programme was priced at below-market rates. However, protocol and border sales during the Programme should properly be analyzed in terms of lost revenue to the escrow account. Following the passage of Security Council Resolution 1284 on December 17, 1999, Iraq could sell unlimited volumes of oil under the Programme. Had Iraq sold the oil it smuggled to Jordan, Syria, and other parties between January 2000 and March 2003 under the Programme at prices approved by the United Nations, the escrow account would have benefited from an additional \$1.78 billion in oil sales.<sup>53</sup>

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<sup>51</sup> TaR (1996-2003). The contracts and number of barrels for recipients of oil allocations are subsets of TaR derived from Ministry of Oil records between 1997 and 2003. For a detailed discussion of Iraq's oil pricing policy and the market conditions that it created, see Part II of Chapter 3 in Volume II.

<sup>52</sup> This is discussed further in Chapter 3 of Volume II.

<sup>53</sup> S/RES/1284, para. 15 (Dec. 17, 1999); SOMO records. For a discussion of the concessional prices at which Iraq sold oil that was smuggled to its neighbors, see Chapter 4 of Volume II. The quantity estimate is based on the crude oil sold only through protocols and private sales. Many other products were sold through the protocols and in private sales. However, only crude oil could be sold through the Programme. Prices were derived by taking the weighted average prices of crude oil sold in the Programme for each of the Programme's price categories (Year, Oil Type, and Destination) and multiplying those by the amounts of crude oil sold annually in the protocols and through private sales, as reflected in the SOMO database. The total additional profit \$1.78 billion is the difference between \$5.3 billion invoiced compared to \$7.1 billion if the same number of barrels (326 million) were sold at the higher prices that prevailed under the Programme.

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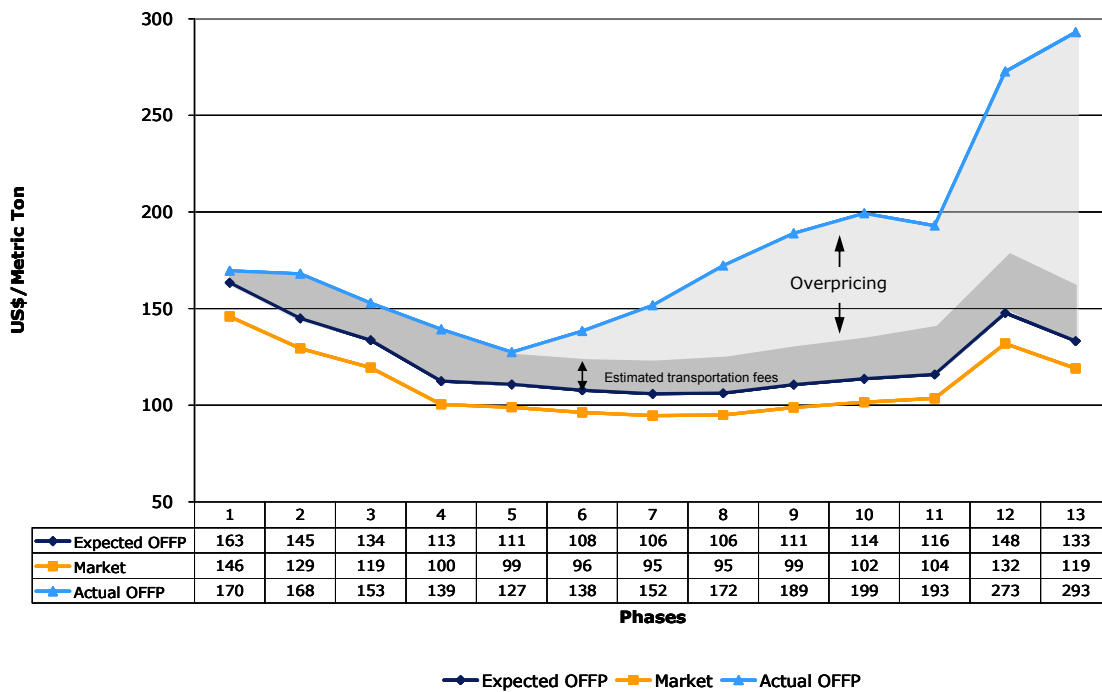
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## C. OVERPRICING OF HUMANITARIAN GOODS

In order to identify instances where Iraq may have purchased goods at inflated prices, the Committee compared the Programme prices of three key commodities with corresponding market prices. The results of this analysis with respect to one commodity are illustrated in Chart C below. This chart plots three values: (1) the market rate of the commodity; (2) the “expected” Programme price, calculated by adding the costs of sea freight to market prices; and (3) the actual Programme price.<sup>54</sup>

Chart C – Comparison of Market, Programme and Expected Programme Commodity Prices



<sup>54</sup> TaR (1996-2005). Market information was obtained from historical commodity data on Capital Commodity Services, Inc. from March 1997 to March 2003, which were averaged over each phrase of the Programme. Capital Commodity Services, Inc. “Historical Futures Charts,” <http://www.ccstrade.com/quotes/historical>. Transportation costs were calculated by averaging transportation costs from historical information from the Grain Transportation Reports of the Agricultural Marketing Service and from records obtained by the Committee and averaged over each phase of the Programme. Agricultural Marketing Service, “Grain Transportation Report,” <http://www.ams.usda.gov/tmdtsb/grain/Archive.htm>. The average cost of vessel freight was then calculated by applying a twelve percent premium per metric ton to the commodity market price to determine the expected price of the commodity.

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As noted in the chart, in Phases I through V, the actual Programme prices were generally aligned with the expected Programme prices. The price differences that did exist between these two values in all likelihood reflected the cost of doing business in a high-risk and uncertain legal and political environment. Beginning in Phase VI, around the time of the introduction of transportation fees, the difference between expected Programme prices and actual Programme prices increased significantly. In the summer of 2000, or Phase VIII, when after-sales-service fees were imposed, these two prices diverged markedly. By early 2003, or Phase XIII, the difference between expected and actual Programme prices was nearly three times greater. The increases in actual Programme prices observed in 2002-2003 can be partially attributed to the kickback schemes described above. However, the sheer size of the price differential seems to exceed the requirements for collecting after-sales-service and transportation fees. The reasons for this excessive overpricing are largely unclear, but may relate to the Government of Iraq's efforts to retain the business of suppliers uncomfortable with their continued obligation to pay kickbacks.

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## V. SUMMARY OF ILLICIT INCOME EARNED

Table 5 provides a summary of the Committee's estimate of the illicit income earned by the Iraqi regime during the sanctions period. The table is divided into two sections: (1) smuggling revenue; and (2) Programme-related revenue.<sup>55</sup>

**Table 5 – Summary of Estimate of Illicit Income (in USD millions)**

	Revenue Prior to the Programme	Revenue During the Programme	Total Revenue
<b><u>Protocol &amp; Private Sales Revenue</u></b>			
<i>Protocol Revenue</i>			
Jordan	\$ 2,599.8	\$ 3,376.6	\$ 5,976.4
Egypt		44.8	44.8
Turkey		806.7	806.7
Syria		3,132.1	3,132.1
Sub-total of Protocol Revenue	2,599.8	7,360.0	9,959.8
<i>Border Trade</i>	-	1,030.4	1,030.4
<b>Total Protocol and Private Sales Revenue</b>	<b>\$ 2,599.8</b>	<b>\$ 8,390.4</b>	<b>\$ 10,990.2</b>
<b><u>Programme-Related Revenue</u></b>			
<i>Transaction Fees on Oil Sales</i>			
Surcharges on Oil Sales		\$ 228.8	\$ 228.8
<i>Transaction Fees on Humanitarian Purchases</i>			
After-Sales-Service Fees		1,055.9	1,055.9
Inland Transportation Fees		527.5	527.5
Sub-total of Transaction Fees on Humanitarian Purchases		1,583.4	1,583.4
<b>Total Programme-Related Revenue</b>		<b>\$ 1,812.2</b>	<b>\$ 1,812.2</b>
<b>Total Estimated Illicit Income</b>	<b>\$ 2,599.8</b>	<b>\$ 10,202.6</b>	<b>\$ 12,802.4</b>

This estimate of illicit income—\$12.8 billion—sets out in quantitative terms the consequences of the United Nations' failure to properly oversee the Programme and maintain the integrity of the sanctions regime.

<sup>55</sup> The Committee considered the question of interest earnings on the cash components of illicit income. Testing of accounts in Jordan show that there was some amount of interest earned; however, the amounts were relatively negligible in regard to the totals above. For this reason, the Committee does not include interest as a component in its estimate of illicit income.