

United Nations

INTEROFFICE MEMORANDUM



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MEMORANDUM INTERIEUR

INTERNAL AUDIT DIVISION I
OFFICE OF INTERNAL OVERSIGHT SERVICES

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

DATE: 2 June 2005

REFERENCE: AUD-7-7:1(031⁸/05)

FROM: Patricia Azarias, Director,
DE: Internal Audit Division 1, OIOS

A handwritten signature in black ink that reads "P. Azarias".

SUBJECT: **OIOS Assignment No. AF2004/820/05: OIOS advisory opinion on the**
OBJET: **review of the selected UNCC "D" claims**

1. I am pleased to present herewith the final report on the above-mentioned advisory service, which was conducted during December 2004 in accordance with the terms of reference agreed upon between UNCC and OIOS.

2. Based on your response, recommendation 1, 2 and 3 will remain open in the OIOS recommendation database. In order for us to close out the recommendations, we request that you provide us with additional information as indicated in the text of the report and a time schedule for implementing each of the recommendations. Please refer to the recommendation number concerned to facilitate monitoring of their implementation status.

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

I. INTRODUCTION, OBJECTIVES AND SCOPE

4. The UNCC secretariat conducted a fact finding mission in Kuwait during December 2004, to obtain and evaluate additional information on 79 selected "D" claims¹ where UNCC had found indications of a high risk of overstatement. The selected claims seeking compensation of damages and losses due to the Iraqi invasion in 1990 ranged from \$1 million to \$7 million, were submitted in 2002 based on the special consideration of the UNCC Governing Council decision to allow late submission of Palestinian claims. The UNCC mission team interviewed these 79 individual claimants and the six audit firms, which issued audited financial statements supporting the claims. The team also visited the accounting regulatory body of Kuwait.

5. As agreed, OIOS provided UNCC with an independent professional advisory opinion on auditing and investigative matters regarding the above mentioned claims during the fact finding

¹ D claims involve individual claims for damages exceeding \$100,000 each.

mission. OIOS participated in 11 interviews with individual claimants, visited two audit firms and the accounting regulatory body of Kuwait, accompanying the mission team leader. This report is based on OIOS' independent observations and conclusions and is not to be included in the final report of the UNCC mission team to the UNCC Panels of Commissioners.

II. FINDINGS AND RECOMMENDATIONS

A. Review of selected claims

6. Below are some examples of the irregularities identified in our review of documents submitted by the claimant and from interviews conducted during the mission. Some of the irregularities such as document tampering appeared to be fraudulent while others were circumstantial depending on the nature of evidence. In any event, these irregularities strongly suggested that the claims reviewed had been deliberately overstated.

Claim No. 3011337 for \$4.5 million

7. The team found that more than 100 of the purchase invoices that the claimant submitted were tampered with. It was clear that these purchase invoices were photocopied after the claimant's business logo was affixed over some other company's purchase invoices. The purchase invoices were the basis for the claimant to seek compensation for the loss of his business inventory consisting of numerous imported luxury goods such as Italian clothing, shoes, baggage, etc.

8. When asked to explain the apparent document tampering, the claimant admitted that he had tampered with the invoices. According to him, the original invoices bore the logo of another business that he owned. When asked why he did not submit the correct purchase invoices and an explanation that he also owned another business, the claimant stated that he thought it would be too complicated to prove that he also owned this business. Indeed, it was difficult for foreigners residing in Kuwait to prove their business ownership due to the local law (see paragraph 32-35 for the related discussion). However, document tampering is a criminal activity in many countries. For example, submitting false insurance documents to obtain compensation for damages regardless of whether he actually owned the "another" business or not could result in criminal charges.

Claim No. 3012166 for \$1.7 million

9. Our review of this claim revealed that some documents submitted were unreliable. The claimant, who bought and sold scrap metal, submitted photocopies of audited financial statements for the period 1988 to 1990 in his claim submitted in 2002. When UNCC requested the original audited financial statements, the claimant submitted what was supposed to be the original documents for the period 1988 to 1990. However, the original statements contained the website and email address of the audit firm (Technical Auditing Office) while the photocopies did not. Also, the audit firm's letterhead and the positioning of the auditor's stamp were different. The photocopies clearly differed from the originals.

10. In addition, it was likely that the 18 September 1991 issue date shown and the audit firm on the "original" audited financial statements was fraudulent. Firstly, the firm's website and an email address were printed on the "original" audited financial statements, which was improbable for 1991. Secondly, the financial statements contained a line item called "compensation claims" with a note

explaining that this represented the loss suffered by the Iraqi invasion to be claimed. In 1991, it was impossible to foresee any compensation claims because the UNCC programme began in 1996.

11. In addition, the issues relating to the audited financial statements, the team found clear evidence that this claim was overstated. Comparison of the stock statement (inventory list) as of 31 July 1990 with the corresponding purchase invoices revealed that the stock statement was based on selling prices rather than the cost shown in the purchase invoices. Accounting standards prescribe that inventory must be recorded and valued at cost until sold.

Claim No. 3012105 for \$8.3 million

12. The team found that this claim lacked credibility due to contradictions and inconsistencies. The claimant's audited financial statements were not credible. The initial claim in 2002 clearly stated that all financial information, such as accounting records, bank statements or invoices for the period prior to the invasion, was lost. However, after UNCC requested further information, the claimant submitted the audited annual financial statements for 1987 to 1990. The claimant was asked how he was able to provide audited annual financial statements while all of his financial information was declared lost. He replied that his in-house accountant, who had left the country and who had not been in contact for many years, took care of all accounting matters. Therefore, the claimant had no knowledge of how his accounts were prepared.

13. The claimant further stated that, after UNCC requested additional information, he remembered the auditor of his firm named International Auditing Center (IAC) who kept, and provided the claimant with, a copy of the audited financial statements. This statement did not seem credible because it is unlikely that his auditor would keep a copy of financial statements of a client² for over 10 years. The claimant then stated that the audited financial statements should be "solidly" correct and good because the auditor used to visit his business site "all the time." When asked how often the auditor visited his business site, he said at least three times a month.

14. The claimant said he paid an audit fee of 300 Kuwait Dinar (\$900) per year. When asked why the audit fee was so low despite the auditor's frequent visits, he said that the auditor was his friend, and gave him a good price. When asked, the claimant said he paid the audit fee once every three years. Such terms did not make sense, since the claimant could not name this auditor, which contradicted his earlier statement that this auditor was his good friend. Considering what was found during visits to the audit firm (see paragraph 21 – 25), the team could not rule out that his audited financial statements for 1987 to 1990 were prepared after 2002 in an attempt to strengthen the claim.

15. There was inconsistency in the claimant's business address. The addresses shown on his UNCC claim form, on his business license and on his store lease agreement were all different. When asked, he repeatedly stated through his interpreter, that this was just a mistake, but he was not able to provide a specific reason for the three different addresses.

16. The team also found that, while the claimant claimed his forfeited payment for a fee to the Canadian government for his allegedly accepted immigration application to Canada, the payment was in fact a payment to an immigration broker and clearly did not substantiate his claim. The

² The required record retention period was up to 10 years, according to the local auditing regulation.

claimant had sought the compensation in the amount of \$23,000 for the fee supposedly paid to the Canadian government and \$50,000 for the associated psychological suffering.

17. The claimant stated that the Canadian government had already accepted his entry into Canada subject only to medical clearance. However, before he had completed his medical clearance, the Iraqi invasion occurred, and his family members moved to various countries. As a result, he could not obtain medical clearance for himself and his family due to the chaotic Iraqi occupation lasting nine months. In the meantime, the Canadian government immigration approval had expired, and the fee paid was not refundable. When asked whether he had proof of the payment to the Canadian government, he replied affirmatively and later submitted a payment receipt to an immigration broker rather than to the Canadian government.

Claim No. 3012255 for \$ 1.7 million

18. According to the claimant his stocks of jewelry, valued at \$1.7 million, were stolen from his store by the invading Iraqi soldiers. To prove his loss, he submitted a police report, which showed the loss of one air conditioner, one broken safe (without any mention of its contents), the shop's furniture and fixtures, and a machine for gold designing. He reported no loss of jewelry. Furthermore, the police report referred to the shop as shop no. 9 while the claimant had indicated his shop as no. 5 in his claim. The claimant explained that the police made an error. At this time, it would be impossible to validate the contents of the 1991 police report, which was written shortly after the invasion was over. However, his statement was not credible because it was difficult to believe that the police would make such a fundamental mistake. Furthermore, if the loss of all jewelry stocks in the amount of \$1.7 million indeed happened, the police report should have mentioned it, and not only the other miscellaneous items. Therefore, the police report would not support his claim.

19. One noteworthy aspect about this claimant was that, during the entire 3-hour interview session, he seldom made eye contact with any of the UNCC interviewers. The claimant looked down at the desk during most of the interview except for a few moments when he looked at his interpreter. Avoidance of eye contact, although it cannot be used to support a conclusion in fraud related interviews, can be regarded as a possible indicator of a guilty conscience or unwillingness to confront the topic.

Claim No. 3012059 for \$2.7 million

20. It was highly likely that this claim was overstated. The claimant, in the retail furniture business, claimed the loss of his stock inventory valued at \$2 million based on his alleged stock balance as of 31 December 1989, consisting of 1,704 dining tables, 8,153 chairs, 627 other types of tables and other numerous items. It was unlikely that a retailer could have this level of stock unless his business dominated the local furniture market in 1989. His business was one of the medium size stores in the local market. Moreover, the team found that his insurance policy in 1989 only provided coverage up to \$400,000.

B. Prevailing factors contributing to the high risks

Industrialized marketing approach to filing claims by some audit firms

21. OIOS found that most of the claims reviewed were prepared in a systematically industrialized manner, which OIOS believes, resulted in a high risk of overstatement. Discussions with the audit firms that issued audited financial statements for the claimants revealed that they were actively involved in preparing hundreds of UNCC claims and charged claimants a fee of at least 2-10 per cent per dollar compensated by UNCC, if their claims were compensated. Charging a contingency fee under local auditing regulations, could provide a strong incentive for the audit firms to overstate their clients' claims.

22. The team also found telling irregularities in some of the audited financial statements issued by the firms. OIOS participated in a visit to an audit firm, International Auditing Center (IAC), because of alarming irregularities found in the audited financial statements issued by IAC for some claims. Some of these statements were of poor quality.

- The auditor's signatures and stamps were visually inconsistent from one claim to another claim;
- The initial contact to IAC revealed that it was once dissolved and subsequently reopened with another business name; and
- The letterheads were inconsistent.

23. The team met with the owner, the only certified auditor at IAC, whose signature differed from one claim to another. When asked how many clients with UNCC claims he had, he stated that he had about 350 such clients and briefly showed us a list of some clients. He noted that his firm charged a one time fee of about 300 KD (\$900) for claims limited to issuing audited financial statements, but charged 2-10 per cent of the amount actually awarded by UNCC for the claims where his firm prepared the entire claim³. According to the owner, many other businesses such as audit firms, trading companies and translation companies had received substantial fees for providing the same service for UNCC claims.

24. When the team showed the audit or the questionable signatures and stamps, the auditor requested another meeting in a few days stating that he needed more time to review these matters. In the meantime, when the team inquired the Kuwaiti Department of Commerce whether IAC had a valid license, the Department notified the team that it took disciplinary action against this audit firm due to repeated findings of poor quality audit reports. At the second meeting two days later, IAC's owner stated that one signature and one stamp on a financial statement was forged. He stated that this might have been done by one of his employees and that he would start his own investigation. Also, he stated that the number of his clients with UNCC claims was less than 100, and not the 350 as previously stated.

25. The team also found that another audit firm issued identical audited financial statements for two different claims. OIOS recognizes that the questionable quality and irregularities relating to these two audit firms are not necessarily representative of the entire Kuwaiti audit industry

³ According to the Kuwait Association of Accountants and Auditors, charging contingency fees is prohibited in Kuwait audit industry, which is also the case in U.S and many of the countries.

consisting of about 120 audit firms. However, as many other accounting firms prospered in the business of supporting UNCC claims, OIOS believes that audited financial statements submitted, although audited by a certified auditor, should not be regarded as sufficient evidence of the amount claimed.

Recommendation 1

UNCC should not regard the audited financial statements submitted in general, especially by the said audit firms, as sufficient evidence of the value claimed for compensation (AF2004/820/05/01).

26. *The UNCC secretariat stated that the "D2" panel of Commissioners of the UNCC and the UNCC secretariat share the concerns expressed by OIOS concerning the reliability of the audited financial statements proffered by a number of claimants in supports of the Palestinian category "D" claims. Indeed, the technical missions undertaken by the UNCC secretariat to Kuwait and Jordan in December 2004 and January 2004 respectively in connection with this claims were prompted by these concerns. While the UNCC secretariat will bring OIOS' recommendation to the attention of the "D2" Panel of Commissioners, it is for the Panel to decide to what extend, if any, audited financial statements should be regarded as valid evidence. In the regard, the UNCC secretariat advises that the "D2" Panel is undertaking a case by case assessment of each set of audited financial statements to determine whether any reliance should be placed upon them. OIOS considers Recommendation 1 accepted. Recommendation 1 will remain open in the OIOS recommendation database until the decision of the "D2" Panel of Commissioners on this matter is made and is communicated to OIOS.*

No punishment for fraudulent claims

27. OIOS believes that there was a very high risk of intentional or fraudulent overstatement in the cases reviewed due to the absence of any punishment by UNCC for such claims, which would amount to prosecutable criminal offenses in many countries. In this regard, there was no arrangement to refer cases of presumptive fraud committed by claimants to the national government authorities or to OIOS for investigation. This could have served as an effective preventive deterrent. As a result, the claimants were in an environment where they had nothing to lose by intentionally or fraudulently overstating their claims. Therefore, UNCC is advised to exercise utmost caution in processing the above selected and remaining claims. UNCC is also reminded that OIOS has addressed the issue of fraudulent claims and made a relevant recommendation in its audit of D1 claims, 19th installment (assignment no. AF2004/820/03).

Recommendation 2 and 3

UNCC should:

- (i) Establish a mechanism to investigate all cases of presumptive fraud involving claimants filing false, overstated or misleading claims (AF2004/820/05/02); and
- (ii) Take action to prosecute cases of filing false, deliberately overstated, and misleading claims designed to defraud UNCC (AF2004/820/05/03).

28. The UNCC secretariat stated that *the "D2" Panel is well aware of the particular risks of overstatement associated with this claims population and is exercising, to use the words of OIOS, "utmost caution" in its review of these claims. In that regard, the secretariat notes that most claimants in these claims categories have not been awarded the full amount claimed and a significant number of claimants have received no award at all. In addition, the Panel is making adjustments for overstatements in individual claims and will also consider whether to make global adjustments with respect to certain loss types that may be particularly susceptible to the risk of overstatement. Such measures are within the Panel's mandate, which is to verify and value claims and in doing so to consider the sufficiency of the evidence against the evidentiary standard established by the Governing Council in article 35 of the Rules.*

29. *However, as the UNCC secretariat noted in its responses to the OIOS audits of part three of the nineteenth installment of category "D" claims and the tenth installment of "E1" claims, it is not within the Commission's mandate to attempt to penalize or censure claimants outside of the verification and valuation of their claims. Also, the secretariat was of the opinion that the cost of conducting such investigations or prosecuting such cases should not be borne by Iraq.*

30. The secretariat further stated that *such investigations are more properly within the purview of domestic criminal and/or civil legal systems. Since claims are filed with the Commission by submitting Governments and those Governments receive the reports and recommendations of the Panels of Commissioners approved by the Governing council, they are in a position to consider whether and what action may be appropriate. The secretariat also stated that it stands ready to forward a copy of OIOS' report to the Palestinian Authority once the "D2" Panel has signed its reports and the Governing Council has approved it.*

31. OIOS notes that the UNCC secretariat agrees with the need of investigating presumptively fraudulent claims and prosecuting false, deliberately overstated, and misleading claims. OIOS also concurs with the Secretariat's position to forward a copy of OIOS' report to the relevant governments. However, OIOS is of opinion that merely limiting awards in the fraudulent claims is not a sufficient measure against such claims and that the UNCC secretariat should officially bring the need to establish a mechanism of investigating and prosecuting fraudulent claims to the attention of the Governing Council. OIOS reiterates Recommendation 2 and 3, which will remain open in the OIOS recommendation database.

Proof of ownership

32. This issue is already well known to UNCC, but it is worth discussing in order to explain the circumstantial nature of certain aspects of the claims, which would require UNCC to exercise professional judgment to verify. Non-Kuwaiti business owners who resided in Kuwait during the Iraqi invasion in 1990 submitted the claims discussed above. As these claimants were not Kuwaiti citizens UNCC faced a unique challenge in verifying their business ownership under Kuwaiti law. According to the law, foreigners cannot be registered as the legal owner of a business, but must have a Kuwaiti partner for this purpose. Often, the Kuwaiti partner was not involved in running the business at all but merely lent his or her name for a fee. This was known as "rent-a-permit," and was possible because there is no income tax system in Kuwait for its nationals.

33. The claimants declared that their Kuwaiti partners were merely lending their names to comply with the law. Hence, the claimants were the sole owners of the respective businesses and

sought compensation for the entire claimed loss pertaining to their businesses. However, the only evidence submitted by the claimants to prove their business ownership was the statements supposedly written by their respective Kuwaiti partners or witnesses. It would be very difficult, technically and in terms of resources, for UNCC to authenticate the written statements and to ensure that the claimants were claiming losses of a business that indeed belonged to them. For example, according to some claimants, their Kuwaiti partners were now deceased.

34. To address this challenge, the team searched the UNCC claims database to determine whether the Kuwaiti partners had filed duplicate claims for the same loss. No duplicate claims were found. Second, during interviews, the team asked the claimants specifically designed questions related to the details of the businesses that the true owners were supposed to be familiar with; such as the names of major customers and their share of sales, the names of suppliers and their share of purchases, the names of major competitors, detailed information about cash and bank accounts, accounting, etc.

35. The responses were cross-checked with the information already submitted in the claims. OIOS observed that responses from most of the claimants did not provide satisfactory assurance that they were the true owners. However, the nature of the information that the team attempted to verify was circumstantial under the local environment and the questions therefore did not yield conclusive results. The team would eventually have to exercise judgment in presenting a range of options for the UNCC Panel of Commissioners to consider when making final decisions.

III. CONCLUSION

36. In evaluating the above-mentioned claims, the UNCC mission team identified numerous irregularities and major inconsistencies and concluded that the claims were more than likely overstated. The team will report its findings to the UNCC Panel of Commissioners and will make specific recommendations pertaining to each claim. While participating in the work of the UNCC mission team, OIOS found that the risk of intentional and fraudulent overstatement in the claims reviewed was extremely high, at least in part due to the following factors.

- Quite a few claims were prepared in a systematically industrialized manner by some audit firms, which had strong incentives to overstate the claims, while providing unacceptable quality products in some cases.
- UNCC had not instituted a mechanism to penalize intentional and fraudulent overstatement, which would have served as an effective preventive deterrent.
- There were unique local conditions, such as authenticating ownership of the business losses claimed.

IV. ACKNOWLEDGEMENT

37. We wish to express our appreciation to the management and staff of UNCC for the assistance and cooperation extended to the auditors during this assignment.