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DFID INTERNAL AUDIT DEPARTMENT

VISIT REPORT

BASRA, IRAQ 26th-31st JULY 2005

1. INTRODUCTION

1.1 Internal Audit Department is an independent review function that provides the Accounting Officer and DFID management with an opinion on the systems of control, risk management and corporate governance in DFID.

1.2 IAD has an annual programme of work that is approved by the Audit Committee. This programme is supplemented and complemented by other work on high-risk areas (such as input to developing systems, investigations, ad hoc reviews) usually at the request of senior management. Our work in Basra was in response to such a request.

1.3 The management of MENAD asked IAD to visit Basra to carry out a review of elements of the Southern Iraq Employment and Services Programme (SIESP) and identify potential lessons for future Southern Iraq programmes, in particular the Iraq Infrastructure Project (IISP). Terms of Reference for IAD's visit are at Annex A.

1.4 We interviewed staff in London and in Basra and reviewed files and other documentation.

2. SIESP - GENERAL

2.1 SIESP start date, according to PRISM information, was 23rd August 2004.

2.2 SIESP had two main aims – employment generation and provision of infrastructure services. The budget for the programme was overall £16.5 million. This was broken down as £10 million on infrastructure services; £6 million on employment generation and £0.5 million on programme administration.

2.3 The main purpose of our visit was to review the employment generation component of SIESP and in particular comment on the reasons for the apparent failure of this component, the extent of that failure and the lessons that can be learned for other projects.

2.4 We were asked to carry out an urgent review of the project following a visit to Iraq by the Head of MENAD and with reference to an Impact Assessment of SIESP (Employment Component) by the DFID Basra office. The assessment raised some worrying issues. Our review confirmed the

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points made in the Impact Assessment paper (shown at Annex B) and we agree the analysis therein.

3. SIESP - EMPLOYMENT GENERATION

3.1 In our opinion, there were a number of flaws in the concept and design of the employment generation component of SIESP. Although this judgement is made with the benefit of hindsight, there were some elementary errors made and there should be lessons learned.

3.2 A key driver of the project design was the political (and consequent senior management) pressure from around Whitehall and beyond to achieve visible results in the aftermath of the war. In retrospect, these pressures appear unreasonable but at the time were generally irresistible. The objective of the employment component of SIESP was to create 1.75 million days of employment. Even at the time, there was unheeded counsel against proceeding with a scheme with such high fiduciary risk and intangible benefit. There was also a strong suggestion (the genesis of which is unclear but deriving from the continued need for perceptible action) that the SIESP Programme (including employment generation funding) should be doubled. This was in late December 2004/early January 2005 before there was any evaluation of – or even monitoring information about – the first phase. IAD, amongst others, advised the desk against this (see Annex C); the doubling did not go ahead.

3.3 There appeared to be little appropriate advisory input from headquarters. The lead adviser was an infrastructure specialist, which accorded with infrastructure components of SIESP but not with the very different needs of designing an employment generation scheme. If such expertise does, or did, exist in DFID it is probably in the social development or governance or perhaps even enterprise disciplines.

3.4 The project was designed to work through the newly formed Iraqi Provincial Councils (PCs). The PCs would apply to DFID Basra and, on approval from DFID, would use contractors to hire unemployed and (usually) unskilled labour to carry out routine tasks (cleaning, low-tech construction, refurbishment, tree planting etc). Working with the PCs turned out to be a misjudgement. The original PCs, which were unelected, were not very robust entities and there is evidence of widespread corruption within the PCs and between PCs and the contractors they used to implement the individual employment projects.

3.5 The projects submitted for approval were of variable or poor quality but there was a low take-up of the scheme and therefore projects were approved which may otherwise have been rejected. Another key weakness in the design and implementation of the employment component was the lack of physical monitoring. The security situation in Iraq, even in the relatively calm southern provinces, was such that there was little chance of DFID project staff visiting projects and seeing people at work.

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3.6 In one province, Maysan, the employment component of SIESP was managed by the British military. Here the Army, which was under particular threat of civil unrest, bypassed the PC and worked directly with contractors. It was very much in the Army's interest to use the programme as a way of quickly "winning hearts and minds". The Army was able to monitor the Maysan projects as part of its routine patrol activity. However, even the Army could not provide enough resource to monitor this type of project to an adequate level. In our opinion, the fact that only military access succeeded (and even then sporadically) is an indication that the country was not ready for this type of development intervention.

3.7 Later in the scheme it was decided to work with local NGOs rather than just PCs. This turned out to have similar results, with the NGOs being largely unreliable and/or corrupt. A DFID Basra SAIC discovered a fraud perpetrated by the local contractor engaged by DFID to deal with NGOs. The contractor had contacts with NGOs and was allowing payments against false outputs. There were also conflicts of interest between the contractor and at least two project managers.

3.8 There is very poor capacity in local NGOs. Many appear to have been set up with the aim of simply obtaining funds from donors. The availability of funds, the lack of local knowledge and widespread corruption has encouraged the growth of bogus NGOs. We should be surprised if SIESP is the only vulnerable project in this environment.

4. OFFICE ADMINISTRATION

4.1 There were a number of weaknesses in the administration of the DFID Office in Basra that had an impact on SIESP. We accept that the office was set up very hastily under pressure from UK and locally to show a DFID presence following the war. There was, understandably, a great deal of difficulty in persuading staff to serve in Iraq. This led to the appointment of people to the Basra Office who had little or no experience in managing programmes or staff.

4.2

It is clear now that the appointed to DFID Basra did not have the required experience or expertise to maintain adequate stewardship over projects such as SIESP. Although the officer's shortcomings were known to senior management and HR, it was considered that there were no alternatives to this posting. In our opinion, HR needs to appraise other options to deal with this type of situation. Given the increase of DFID's involvement in fragile states and conflict areas, such a posting crisis is likely to happen again. DFID will need to consider eg incentives, mobility clauses, and secondments from other organisations, to ensure that difficult but high priority posts are filled with people with the right skills and experience.

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4.3 DFID had problems attracting more junior staff to serve in Basra. This led to the appointment of a temporary C1/B2 on the Iraq desk to carry out an office manager/deputy programme manager job in Basra. She was given a contract (at indeterminate grade) that ran from September 2004 and was extended to end finally in August 2005. By the end of its term, the contract will have breached the OJEU threshold. Furthermore, there are probably employment rights concerns to be addressed. She has performed extremely well in her post but she has not had the support from DFID to which a member of staff would be entitled (training, promotion and posting opportunities etc). Also, when her contract ends, DFID will lose the institutional memory that she has built up over the last year.

4.4 A key control in the management of any work is clarity of roles and responsibilities and lines of authority and accountability. Due to the systemic and personnel weaknesses mentioned above, the roles and responsibilities for SIESP were not clear. Again, although it is understandable how this happened – post-conflict urgency and confusion – it is not a sustainable way to run a project. The procedures for SIESP look sound on paper; the problems were in the judgements made and who was accountable for them. at ground level it was left to consultants to run the project almost completely without DFID input.

5. SIESP - FINANCIAL MANAGEMENT

5.1 Financial management was difficult on SIESP. For example, problems with the Iraqi banking system led to the need to transport and hold huge amounts of cash. However, the Basra Office did put in place some good controls over finances. Two features stand out. Payments in advance were kept to a minimum, which limited exposure; and secondly, cheques were used extensively. The accounting records are thorough and it is possible to trace amounts through the DFID Basra records despite the multi currency transactions.

5.2 The holding of large amounts of cash in an office safe is a very high risk. At the time of our visit there were (we did not verify in the time) some \$3.5million held. More than one person had access to the safe combination, therefore if any cash went missing they would all be suspects. We gave some advice on cash handling and were told that this would be dealt with as the new projects came on stream.

5.3 Following the Impact Assessment, it was decided to stop the employment generation aspects of SIESP. The IAD visit was part of the closure. Closing the unsuccessful component early saved about £3million. Of the £6million originally allocated to employment generation, about £3million was disbursed. About £1million was spent on military run projects in Maysan with only limited success. However, it is still likely that well over £2million of SIESP money did not meet objectives, that is, was not spent on employment creation. This is IAD's view following our visit. It is difficult to make a precise

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analysis of the sums lost because of the lack of information from physical monitoring. We checked that the figures shown in the Impact Assessment accurately reflect the available accounting information. Although this sums lost make up a minor part of the programme, there remains the risk that they could be funding insurgency activities and anti-Coalition violence.

5.4 We noted that the Expenditure cubes showed a large amount still charged to the suspense account for SIESP. The SIESP accountants in Basra however had sent sufficient information to HQ for charge-off to the SIESP MIS codes. We were told however by Accounts Group that significant amounts were charged off in the Resource Account year-end adjustments. This removes the risk of attracting a capital charge for outstanding suspense items but leaves an inconsistency on the cubes.

6. SIESP - IMPACT

The Impact Assessment, understandably, presented as positive a view on a failed project component as is possible. However, the assessment, this review and other evidence shows that, not only did the employment generation aspect of SIESP not have the desired impact, it is quite likely that the scheme had a negative impact in that it soured relationships between DFID and PCs and it adversely affected DFID's reputation and credibility with Iraqis and with other agencies (UK military, other donors, bona fide NGOs).

7. IRAQ INFRASTRUCTURE PROJECT (IISP)

7.1 One of the objectives of the IAD visit to Basra was to learn lessons for other programmes in the Iraq portfolio in particular IISP. A most important lesson is that the roles and responsibilities and accountability for a project should be clear and there should be DFID input at key points. The respective roles of London-based staff (Project Officer, Lead Adviser), DFID Basra staff (eg financial monitoring and supervising the consultants) and Basra consultants (eg implementation and technical monitoring) should be clear to all involved in the project. In our opinion the roles in IISP were becoming blurred. During the visit it was announced that World Bank co-financing was to be made available. This led to discussion on the project roles and work is being done to clarify them.

7.2 During our visit we briefly addressed the handling of finances for IISP and the Basra Office in general. We concluded that the principles in the paper on finances by one of the Basra consultants (ie that the roles of incurring, certifying and making payments should be as far as possible separated) were sound. We also considered that the best way forward was for the implementation teams to incur (ie let contracts etc); the Technical Advice Team (TAT) to carry out the technical monitoring and certifying (ie that work was carried out to the correct technical specification); and DFID Basra staff to carry out the payment authorisation and processing. The new office

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manager is likely to receive Imprest account training and should therefore be able to undertake the latter role.

7.3 A more experienced Head of Office has now been appointed to the Basra Office. With a new deputy HoO and more capacity and support from Headquarters, this augurs well for the local supervision of IISP. In our opinion, the designated Project Officer should have a more authoritative role than was the case with SIESP. We note that she is to spend more time in Basra; this should help establish the governance arrangements for IISP, which is already running on a very tight timescale with no leeway.

7.4 A more difficult lesson is how to mobilise local intelligence eg to help monitor IISP. The SAIC staff in the Basra Office were probably aware of the problems faced by SIESP but were either not asked for advice (or did not feel empowered to give advice) until fairly late. SAIC played an important part in exposing the fraud against the jobs scheme by a locally engaged DFID contractor. However, there is a great risk to SAIC in becoming too visibly involved with DFID activities. Management must always keep that in view.

Internal Audit Department
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