

**Federation Ministry of Social Policy, DPs and Refugees (FMSP)**  
**Report of the Special Auditor**

**18 March 2003**

## SUMMARY OF MAJOR ISSUES

1. Tender, contract and/or invoice manipulation resulting in significant overcharges by favored companies. Excessive charges for unnecessary transportation.
2. Significant construction work remains incomplete months after the required completion date and transfer of the funds to FMSP.
3. Poor quality control resulting in substandard construction and failure to meet construction commitments.
4. Ministry management and staff receiving up to four monthly salaries/allowances for doing the same job.
5. Enabling direct or indirect transfers from Government to be removed from Treasury control and placed in lesser controlled bank accounts for donor conferences.
6. Project accounting, recordkeeping and reporting are unreliable, incomplete and inaccurate making it difficult to determine what was required and what was done.
7. Failure to correct abuses noted in previous audits.

## OVERVIEW

Many of the problems surfaced in the June 2001 Audit of Government Accounts have continued resulting in inappropriate selection of favored vendors and inflated billings. Although the Ministry has budgeted for and received funds to complete their projects, the budget was overspent more than 14.3 million KM at the end of 2001 by running up liabilities. In spite of this high level of overspending, projects have not been completed on time. Many projects we reviewed and visited were still incomplete more than 15 months after the initial contract was signed with the beneficiary. We estimate that approximately 800 houses, for which contracts had been signed in September/October of 2001, still remained incomplete at the end of 2002. Work needed to complete these houses is estimated to be in excess of 5.6 million KM.

Just about every major aspect of running this Ministry is poorly controlled. Tenders have been manipulated or simply ignored. Contract terms are not adhered to. Works are not completed as specified on time, and controls to ensure the work gets done properly are non-existent or ineffective. The selection of beneficiaries and regions to help is subject to bias. The process for specifying and controlling material deliveries is weak. Project accounting, recordkeeping and reporting are unreliable, incomplete and inaccurate making it difficult to determine what was required and what was done. The government is providing funds both through the budget process than again directly and indirectly through participation in donor conferences. The donor conference funds, which are not under the Treasury system, are poorly controlled. Funds and projects are mingled and not appropriately accounted for.

One of the major areas of overspending is in transportation costs. Typical transportation costs run from 1.2 to 1.65 KM per kilometer for up to a 10-ton truck. However, certain favored companies are charging as much as 30 KM per kilometer. In addition, goods are being transported across the country, when they do not need to be since other qualified companies had materials available locally. In some cases, the billings for transportation

showed more trucks and/or more kilometers than could reasonably be accounted for. Transportation costs amounted to as much as 33% to 50% of the materials billings for certain companies.

Questionable companies with a record of inappropriate billings, as pointed out in previous audits, continued to be used by the FMSP. Although some of these same vendors failed the tender requirements, they were later accepted as vendors by the "Revision Committee".

Top Ministry management and selected employees are receiving as many as four salaries or allowances from the Ministry and donor groups. These projects are administered by the FMSP during normal working hours and should be fully covered by the salaries paid by the Ministry, which are considered adequate and are in line with salaries paid by other ministries. The staff and management receiving extra salaries may or may not have worked on the projects they received funds from.

The budget for FMSP was 28 million KM for 2001 and 32 million KM for 2002.

### **SUMMARY OF RECOMMENDATIONS**

1. Prevent inappropriate diversion of funds to favored companies.
2. Ensure tender policies are followed and terms are adhered to.
3. Implement controls to ensure beneficiaries receive all benefits they are entitled to within the agreed upon timeframes.
4. Ensure project requirements and limits are met.
5. Improve monitoring of work quality.
6. Ensure Ministry Management and Staff receive only one salary for their work with the Ministry.
7. Implement and enforce proper project accounting controls and recordkeeping.
8. Improve controls over the selection of beneficiaries and regions.
9. Ensure all funds provided directly or indirectly from the government are allocated through the budget process.
10. Consolidate all activities and project accounts for the Ministry.
11. Adhere to budgets.
12. Adhere to Donor Conference mandates.
13. Implement and enforce controls to duplication of beneficiaries.

### **OBJECTIVE AND SCOPE**

This Ministry was last audited by our office as part of the June 2001, Audit of Government Accounts Project in which significant problems were surfaced. As a result, the Financial

Police conducted an investigation, which resulted in criminal charges. This audit took up where the last audit finished primarily covering the period since our last review.

The objective of this limited scope audit is to assess the adequacy of selected internal controls over disbursements to help ensure monies are expended for valid expenditures at competitive and reasonable amounts. Our testing included tests of selected beneficiaries for eligibility and timely receipt of benefits in the amounts, quality and prices dictated by the program. Fieldwork took place from 19 November 2002 through 7 February 2003.

Our testing was limited and did not cover every transaction or attempt to uncover every problem. This is not a financial investigation for the purpose of establishing criminality. Where we found evidence of potential criminal activity, we recommended a Financial Police investigation. This is not an audit of the fairness or reasonableness of the financial statements. Therefore, we express no opinion on the financial statements. Although we may have selected transactions, which affected certain donor agencies, this is not an audit of individual donor agencies. Therefore, we do not present financial information or an opinion on the programs of individual donor agencies.

## FINDINGS & RECOMMENDATIONS

### 1. Prevent inappropriate diversion of funds to favored companies.

Questionable financial practices and expenditures continued unabated in spite of previous audits and Financial police investigations, which pointed out a number of abuses. Some examples of inappropriate expenditures are presented below.

#### Transportation Costs

Below is a chart of major vendors used in 2002. Transportation charges for many of these companies were excessive amounting to as much as 50% of the total materials charges. In many cases the goods could have been obtained locally eliminating transportation costs altogether.

Vendor	Materials Cost	Transport Cost	% Transport Cost
Primo	3,034,807	602,660	19.8
Kuvet	1,560,025	539,233	34.5
Gradiz	1,547,316	674,084	43.5
Aman-Cola	1,223,270	573,382	46.8
Una-SA	785,115	392,212	49.9
Cavkunovic	594,745	73,753	12.4
Lesna	190,637	69,488	33.8

- PRIMO

PRIMO – Vitez was the vendor selected to provide materials to Visoko and Kakanj even though other qualified vendors, such as IGM, were located much closer in Visoko. IGM had previously been qualified to provide material as part of the 2002 tender. The reason for selecting PRIMO over IGM becomes apparent when the transport costs are considered, which amounted to 20% of total materials billings. A similar situation took place in the municipality of Bosanska Krupa. PRIMO Vitez was selected to supply the materials even though the round trip distance between Vitez and Bosanska Krupa was 620 kilometers and even though local vendors were available. When we checked with the drivers of the trucks, we learned that they, and not PRIMO, owned the trucks. The drivers told us they charge from 1.1 to 1.2 KM per kilometer for transport. PRIMO includes a per kilometer transportation charge plus an additional charge per ton. With everything included they charge approximately 30 KM per kilometer. These inflated transportation charges amount to a mark-up on transportation of between 1875% to 3000% for materials, which could have been obtained locally. Inappropriately writing contracts to enable inflated transportation costs does not excuse this level of overcharging.

We recommend the Financial Police investigate the transactions with PRIMO and their relationship with the individuals who authorized the transactions.

- Poljooprema

The 2001 First Donors Conference for BiH collected 2.5 million KM for construction of homes. The FMSP borrowed 450,700 KM from the First Donors Conference for BiH and paid that plus another 450,700 KM to Poljooprema for agriculture supplies and equipment. The two payments equaled the total contract value of 901,400 KM. These pay-

ments were based on an 5 April 2002 decision, stating that the FMSP would borrow 450,700 KM from the Donor's conference to pay Poljooprema and compensate with construction materials for project DS-92. This decision was signed by the President of the Board of Donors, Jozo Ljiljanić after the contract with Poljooprema was signed. On 23 April 2002, Poljooprema issued another two invoices (49,969 KM and 49,993 KM) totaling 99,962 KM on this same contract exceeding the approved contract by that amount. The invoices included items such as oats and barley not specified in the contract, and the price invoiced for potatoes exceeded the contract price.

The money borrowed from the First Donors Conference for BiH was to be repaid by supplying construction materials for Project DS-92. Under this arrangement, FMSP was to provide material for 43 houses. Instead, the Ministry provided all materials and transport costs for the entire project from their budget. The total amount spent on material and transport from FMSP's budget for DS-92 was 1,634,216 KM, which was 1,183,516 KM more than the Ministry was to pay out of their budget. This large amount did not cover material for Phases III and IV for the 61 users in the amount of 216,521 KM.

The projects of donors' conferences should be paid from the conference accounts and not from the Ministry's budget. Since none of the projects had budgets, it was impossible to compare planned spending to actual spending.

Tractors donated by the Chinese government were kept for unreasonably long periods of time at the premises of Poljooprema. Poljooprema charged a total of 61,000 KM for oil, rent, transport and service. Since the 50 tractors were new and were not being used, we question the need for the 33,000 in oil and service charges. Additional transportation charges were also paid on these same tractors.

We recommend the Financial Police investigate payments made from the donor conference bank accounts.

- Kuvet

In the June 2001 audit Kuvet was cited for a number of irregularities including unsubstantiated billings and significant over billing for both goods and shipping. At the time Kuvet was one of their most favored vendors, which had been selected for significant activity. The owners of Kuvet are currently under investigation by the Financial Police in regard to their relationship with FMSP and other issues. In spite of Kuvet's poor performance, the Ministry has continued to do significant business with them. They were the 4<sup>th</sup> largest vendor during the 10 months ended October 2002. During that period, they appear to have continued their pattern of overcharging. Charges for transportation alone amounted to 34.5% of total materials charges.

In addition to the above, in July of 2001 Kuvet was awarded a contract from another donor group to supply food and cleaning supplies. However, they also invoiced for testing and repairing of washing machine pumps, plumbing and sewage works, etc. for which no contract existed. This problem was confirmed in an audit conducted by the donor group, which stated the contract with Kuvet does not cover maintenance. According to one FMSP employee Kuvet did not respect the contractual unit prices in 2001.

We recommend vendors with unsatisfactory performance be immediately dropped from the list of vendors eligible to tender and to do any business with the Ministry or act as sub-contractors. We also recommend the Financial Police ensure their current investigation includes all business transactions with FMSP from 2000, 2001 and 2002 and the relationship of Kuvet's owners and FMSP management and staff who authorized the transactions.

Management responded to these issues by agreeing to limit deliveries to less than 200 km and to limit transportation costs to no more than 10% of the materials cost. We believe management is being responsive to the issue, but wish to recommend that transportation cost be included in the bid price of goods and not appear as separate charges. Our recommended method is quite common in the construction business and is followed by other NGOs involved in similar operations. We see no need for additional charges. If separate charges are assessed, no company should be allowed to charge for kilometers for a round trip as delivery charges are typically charged for a one-way trip.

## **2. Ensure tender policies are followed and terms are adhered to.**

Although tendering takes place for some contracts, it appears the process is used more for appearance than control. Some examples of inappropriate processes follow.

### Revision Committee

According to the May 2001, Tender Evaluation Committee Report, 49 companies submitted offers in response to the public tender for the supply of construction materials. Sixteen companies did not satisfy the criteria and 33 companies met the requirements. On 20 July 2001, Minister S. Halilovic issued a decision overriding the Tender Evaluation Committee's selection due to "certain oversights", for which there was no detailed explanation. The Revision Committee then included 7 companies previously rejected by the Tender Evaluation Committee:

- Gradiz d.j.l. Sarajevo
- Amos dd Tuzla
- Gramis Company doo Kladanj
- Drvopromet doo Turbe, Travnik
- Kuvet doo Ilidza – Sarajevo
- DIP Janj Holding dd – Donji Vakuf
- Inter doo Matuzici, Doboj Jug

We question the need to add back the companies. Some of these companies such as Gradiz and Kuvet are favored companies involved in charging excessive amounts for transportation. Drvopromex and Gradiz specified two different prices for the same item. Kuvet was also cited in past audit reports for questionable practices and unsubstantiated invoices.

The Revision Committee appears to have been established to circumvent the tender process to enable the Ministry to continue to deal with favored and questionable vendors. We

recommend the Financial Police investigate these companies and their transactions with the Ministry of Social Policy and its Ministers and decision-making staff.

#### Double specification of identical items

Upon examination of technical specifications by a qualified architect, who is a member of the audit team, we found that several items were specified twice using different descriptions. Some companies charged the same amount for identical items, other companies did not.



Company name	Item	Price 1 in KM	Price 2 in KM
IGM Visoko	Reinforce steel GA fi 6 mm	0.75	
	Reinforce steel GA fi 8 mm	0.75	
	Reinforce steel R fi 10 mm	0.78	
	Reinforce steel R fi 12 mm	0.78	
	Reinforce grid R - 131	0.85	0.81
	Reinforce grid R - 335	0.83	0.81
Drvopromex - Bugojno	Reinforce steel GA fi 6 mm	0.78	1.60
	Reinforce steel GA fi 8 mm	0.79	1.60
	Reinforce steel R fi 10 mm	0.79	1.55
	Reinforce steel R fi 12 mm	0.79	1.55
	Reinforce grid R - 131	0.75	0.80
	Reinforce grid R - 335	0.82	0.80
Aman Cola - Sarajevo	Reinforce steel GA fi 6 mm	0.75	0.76
	Reinforce steel GA fi 8 mm	0.75	0.76
	Reinforce steel R fi 10 mm	0.72	0.72
	Reinforce steel R fi 12 mm	0.72	0.72
	Reinforce grid R - 131	0.85	0.98
	Reinforce grid R - 335	0.85	0.98
Drvopromet - Bugojno	Reinforce steel GA fi 6 mm	0.79	0.75
	Reinforce steel GA fi 8 mm	0.76	0.75
	Reinforce steel R fi 10 mm	0.72	0.75
	Reinforce steel R fi 12 mm	0.72	0.75
	Reinforce grid R - 131	0.89	0.93
	Reinforce grid R - 335	0.89	0.93
Gradiz - Sarajevo	Reinforce steel GA fi 6 mm	0.71	0.86
	Reinforce steel GA fi 8 mm	0.71	0.86
	Reinforce steel R fi 10 mm	0.71	0.86
	Reinforce steel R fi 12 mm	0.71	0.86
	Reinforce grid R - 131	0.86	
	Reinforce grid R - 335	0.86	
Kes doo - Mostar	Reinforce steel GA fi 6 mm	0.66	0.55
	Reinforce steel GA fi 8 mm	0.66	0.55
	Reinforce steel R fi 10 mm	0.64	0.64
	Reinforce steel R fi 12 mm	0.64	0.64
	Reinforce grid R - 131	0.73	0.71
	Reinforce grid R - 335	0.71	0.71

Putting the same item in a tender twice using two different descriptions can be used to facilitate tender fraud in that it can enable a favored company to win the bid and then bill at the higher price under the second description.

Management agreed to correct this issue in all future tenders.

### Materials Specification

The materials specification for 37 identical houses in the municipalities of Bosanski Samac, Modrica, Vukosavlje and Pelagicevo does not state which type of house (A, B or C) the materials specification refers to. Therefore, we compared delivered materials listed on the signed Hand Over Certificates against the quantities needed to complete the first two phases of a Type A house, which was the highest level of construction allowed. Our comparison revealed that actual expenditures were for larger and more elaborate construction than allowed under the program. Some of the differences for items, such as reinforced steel and concrete blocks, differed by as much as 300%.

We recommend strict controls be implemented over materials specification to ensure the materials are of the quality and quantity required for the type of construction.

### Inappropriate use of vendors

Under current practice the FMSP annually tenders to qualify a variety of vendors to supply and/or transport materials to projects throughout the year. Suppliers are to be located throughout the country with the intent to use the closest supplier. Unfortunately, the practice varies considerably from the intent. Although several vendors will qualify as part of the tender process, those vendors actually used on the jobs are certain favored companies some of which are located far from the site. These vendors then significantly overcharged for transportation. Transportation costs amounted to 33-50% of total billings for these companies.

### Price charged does not match the contract

During our price testing, we noticed a number of irregularities including charging 100% more than the contract price. For example, Aman Cola, the fifth largest vendor used by the Ministry, charged double for a number of products including sand and ceiling rafters. In the case of burned wire, their original contract did not specify a price; but the annex signed a month later obligated the buyer to accept market price for any goods not originally specified in the contract. We compared this "market price" charged to the prices charged by competing vendors and found Aman Cola's prices were 27 to 45% higher than the competition. We tested two invoices from this company and found the overcharges on both. However, the overcharge for sand was caught and adjusted on the 10 December 2001 invoice. No adjustment was made to the earlier and much larger invoice for 440,106 KM.

Aman Cola was also selected via public tender to provide and transport food supplies for a donor project. They significantly overcharged for transportation by charging a rate higher than specified in the contract and inflating the kilometers driven. The invoiced kilometers did not match the delivery notice. Transportation was overcharged by 3,106 KM or almost three times the actual charge of approximately 1,320 KM. The donor group's September 2002 audit report confirmed the inflated unit price.

In reviewing the project, we found that Brutto doo., which delivered food, overcharged from 25 to 33 % on tea and rice.

Management concurred with this issue and agreed to implement appropriate corrective action.

### Differing measurements of quantity

Drvopromet was FMSP's largest supplier of materials. They invoiced in units, which differed from the measurement specified in the contract. The tender/contract specified kilograms, while the invoices showed only pieces. There is no evidence that the FMSP calculated the conversion and compared quantities or requested the vendor to bill in accordance with the contract terms.

The required calculation was completed and submitted to the auditors along with the management's response. However, we wish to stress that the calculation should be done before the payment is processed and should be attached to the payment documentation.

This problem was also found to exist for a number of other vendors.

### Project DS-60 and Mostovi Prijateljstva

Vendors were selected to supply material for the DS-60 project without the benefit of a tender. FMSP is supposed to either publish a tender or make use of a limited offer procedure (depending on budget) in awarding work to be paid for out of donor conference funds. This process was not followed for many projects including the DS-60 project valued at 1,010,304 KM to be paid for out of Donor Conference for BiH funds. Favored vendors were once again selected without tender or contract. A similar situation occurred with the Mostovi Prijateljstva project.

For project DS-60 management confirmed the lack of a separate tender for this project, and stated that they used the vendors selected by the Ministry as part of the general vendor selection previously discussed in this report. Since this is a separate project paid for by separate donor funds, a new tender is required. Management informed us that The Mostovi Prijateljstva project is currently under investigation by the Prosecutor's office.

### Project S-21

This tender was to build 23 houses in Srebrenica. Following the tender process FMSP signed contracts with two companies to construct 21 rather than 23 houses. They claimed there was not enough money in the FMSP budget to construct 23 houses even though the entire project was covered by the Donor's Conference for Srebrenica and was not to come out of the FMSP budget.

One of the vendors selected was Izgradnja-Invest, who were to provide building services for 12 houses at a price of 92,344 KM. The prices were documented in the tender as final prices. However, the contract was awarded for 99,546 KM, which they claimed was due to an increase in service tax.

The construction work on this contract was to be completed in August of 2002. As of February 2003, the work is not done. They blame the delay on late delivery of material by FMSP.

Management confirmed that the selected contractor was not competent to complete the works and they plan on terminating the contract with the company. Their response once again indicates a problem with the vendor selection criteria and process.

### **3. Implement controls to ensure beneficiaries receive all benefits they are entitled to within the agreed upon timeframes.**

#### **Project documentation**

Projects are to be completed within five months of signing the contract with the beneficiary. During our audit we noted numerous instances where the beneficiaries had not received any or only part of their benefits 15 months or more after their contracts had been signed. Materials promised months before were not delivered. We noticed a few deliveries stalled for over a year miraculously partially showed up within a day or two of our visiting a site.

We selected ten beneficiaries in Visoko for testing. The 9-month report provided to us by the Ministry specified that the full donation was provided for all ten users. When we asked for clarification of what was meant by "full donation", FMSP staff told us that they considered all four phases of supply had been completed. However, contrary to the nine-month report, the beneficiaries only received a small portion of what was required for completion of all four phases. Failure to deliver as required was confirmed by discussions with end users and the Visoko Municipality staff. The municipality staff were involved with the distribution of material and maintained the delivery forms and contracts with the end users, which we examined. Four of the ten end users managed to complete their houses with assistance from other donors. The remaining six houses are far from complete, and the only donation received was over seven months ago in July of 2002.

Although the beneficiaries sign a contract, they have no control over what they are to receive or when they are to receive it. The contract contains no specifications regarding what is to be received. When we visited sites, some individuals told us they may or may not be required to sign upon delivery, and what they signed for may or may not actually be delivered. A member of FMSP management told us the beneficiaries at Kozluk told his staff 19 trucks full of goods pulled into town, and the beneficiaries were asked to sign for delivery. Once they signed, the trucks did not unload. Instead the full trucks returned to Sarajevo.

We recommend the beneficiaries be fully informed of their rights and be actively involved in ensuring they get what they are entitled to when they are entitled to receive it. We suggest an agency independent of those who have control over spending, inform the beneficiaries at the time the contract is signed of their rights and provide a phone number where complaints will be immediately and independently followed up. Beneficiaries should be instructed to call when goods are not delivered on time or if attempts are made to bully them into signing for less than they receive. Beneficiaries should be instructed not to sign for anything they do not receive as the signed document will be the basis for documenting their agreement as to delivery.

Management responded by agreeing to produce leaflets stating beneficiary rights and a phone number to call with complaints. The issue of independence was not addressed. We believe that ensuring the independence of the agency which beneficiaries are to call, is critical in controlling the reported problems.

#### **Ministry Six Month, Nine Month and Annual Reports**

The beneficiary/end user lists provided by the Ministry are incorrect and inadequate. It was impossible to identify and locate the end users on the nine-month report as it didn't provide exact location and ID numbers. We could not determine which phase was delivered in 2001 or 2002 or the type of materials. Furthermore, we couldn't determine from the

report whether the donation type was A, B or C, nor which project phase the material applied to nor the year of supply.

For example, when we visited Visoko with 10 end users and Kakanj with 22 end users, we had to obtain support from the municipality in order to identify and locate the end users included in the nine-month report. According to the nine-month report, provided by the Ministry, all end users received "full" donation of material for Type A housing during 2001/2002. However, the amounts shown for four phases was less than ten percent of the amount required to complete all four phases.

Beneficiaries who received material in November/December of 2001 were not included in the Ministry's nine-month report. However, they did appear on the list of 2002 beneficiaries submitted to us on 9 January 2003.

#### **4. Ensure project requirements and limits are met.**

We noted a number of instances where the benefits received were not in line with program requirements.

##### Hadzici – Breza

One individual listed on the 2002 list as a beneficiary in Hadzici, received a donation of "C" type material, which he did not use to rebuild his old house. Instead he built a larger house at another location in Hadzici.

All 22 beneficiaries are on both the 2001 and 2002 list. However, in 2001 they are listed as single beneficiaries. In the 2002 nine-month report some of them are combined. Although 22 beneficiaries were shown, some of the specified materials such as toilet bowls and washing basins, including installation materials, were for 25 users.

##### Kiseljak - Hadzici

Two Bosniaks in the Kiseljak Croatian area, who already had family homes, and were therefore ineligible, were selected as beneficiaries and built new houses with the funds.

An individual rehabilitated his house in 1996 from various donations. He later took off the roof and received funds again to complete.

The grandson of an individual who died 20 years prior, received materials even though he does not even live in the area. He "signed" the materials delivery form and certificate. However, it appears to be two different signatures.

Four individuals entitled to assistance didn't receive anything.

##### Kakanj

In Kakanj, the municipality was not involved in selection and delivery. We could only identify and locate nine of the 22 end users. In all nine cases the houses identified were much bigger than allowed under the House A specification. All nine users said they received some but not all specified material in November of 2001. One end user said they had not received a thing and they reconstructed their house on their own.

One Kakanj end user received a tractor as a donation.

## Zvornik

The municipality was not involved in the selection or distribution. Municipality staff claimed that a number of the rehabilitated houses belong to beneficiaries who are living abroad. They claim these houses are unoccupied while other more deserving refugees live in poor conditions.

Approximately 15-20 beneficiaries signed a contract with the Ministry in September or October of 2001. The contracts ended in February or March of 2002 when the reconstruction works were required to be complete. If a contract goes beyond five months the Ministry can request they be paid back, or the completed house can go to another beneficiary. However, over 15 months later these beneficiaries are still waiting to receive their materials.

During our visit we noticed a load of poor quality materials that was to be delivered. We asked to talk to the person in charge. We were told no one was in charge. The beneficiaries told us the following:

- No Ministry staff was present during delivery.
- The truck driver claimed the materials were for three persons only.
- No hand-over documents were required to be signed.
- They were told specified material would be received next time.
- Beneficiaries do not know what they are supposed to receive and are happy with anything.
- They do not know when the next delivery will be.

Management responded by agreeing to corrective action. We support their actions and recommend they supply additional detail as to how all items in this finding will be corrected. We further recommend that an immediate inventory of incomplete contracts be prepared including line by line identification of materials outstanding and costs of those materials and labor for each beneficiary. This inventory and project record can then serve as the basis for costing each project and monitoring completion. At any given time the project records should be in agreement with the financial records of the Ministry. Periodic independent spot checks should be performed to ensure the records match the status of the construction as confirmed by the beneficiaries and that they balance to the Ministry records of construction in progress and amounts due to beneficiaries. Failure to keep these records up-to-date, accurate and in balance is considered gross mismanagement and should be immediately and appropriately dealt with.

## **5. Improve monitoring of work quality.**

During the audit our architect examined the quality of construction work completed by different construction companies at the Srebrenica sites. We found the both work quality and materials be of low quality, and beneficiaries told us they had to replace some sanitary equipment and ceramic tiles themselves as they were improperly installed. We found cracks in recently erected and plastered walls. Our architect commented that the cracks observed in the plaster occur when the work is not executed in a technically correct manner. The quality of the joinery was also bad. The type of cracks observed appear when the joinery isn't mounted correctly.

The poor quality we observed was previously spotted (and reported on in May of 2002) by the Ambassador of Malaysia, who provided comments regarding work done by the POLET company of Srebrenica, which is one of the FMSP's favored contractors in the area.

The process for monitoring quality should be significantly improved to help ensure the work is conducted appropriately by trained professionals. In addition, the company should be responsible for replacing and repairing work, which does not meet technical standards and specifications. The FMSP should ensure work is promptly inspected during and after construction to catch problems and ensure they are corrected before paying vendors. Vendors who do not appropriately complete work, should be dropped and not used in the future.

Management agreed to issue an instruction on the method to control the quality of construction work for the duration of construction. They will hire an independent construction engineer to head the technical appraisal commission. Contractors who do not comply with the requirements will be removed from the list of contractors eligible to bid for contracts.

#### **6. Ensure Ministry Management and Staff receive only one salary for their work with the Ministry.**

The Ministry of Social Policy and Displaced Persons and Refugees pays salaries of their management and employees. However, during our audit we found several employees were also paid additional monthly allowances from donor groups for doing the job the Ministry is already paying them for. We especially noticed that higher-level management were the individuals frequently selected to receive these allowances.

In addition to his FMSP salary, Mijat Tuka, Deputy Minister, received an additional 2,150 to 2,200 KM per month from three projects in 2001 and 2002. In addition to his FMSP salary, Fehim Bekan, Secretary of FMSP, received 500 KM per month from one project in 2001 and 1,100 KM from two projects in 2002. In order to facilitate payments, the individuals to be paid must sign contracts with a selected representative of the Ministry. Funds are provided to the Ministry and the allowances are paid in cash. However, there are numerous problems with both the method of payment and the individuals selected to receive the payments. The method of making multiple payments to the same individual each month obscures the total compensation received. The individuals selected to receive these payments are top-level Ministry management who are approving themselves to receive payment from multiple sources. For example, Mijat Tuka approved the contracts to pay himself the additional amounts.

This issue was also raised by the Supreme Auditor in their June 2002 report where they noted taxes were not being paid on the additional earnings under the donor contracts.

We understand such allowances may be provided for transition/post-conflict economies for agreed upon specified functions especially where civil service salaries are deemed inadequate to ensure the proper monitoring and reporting on projects. We concur in instances where the employees work on the project and their salaries are insufficient. However, the cases cited in this report are for top-level management as well as staff who are adequately compensated by the Ministry. We believe the Ministry should pay only one salary per employee. If the Ministry receives additional funds on specific projects, which can be used to supplement salaries, the amounts should be added to the salary paid by the Ministry to ensure transparency and collection of appropriate taxes. The process of separate contracts and separate cash payments obscures the issue and should be eliminated. Total monthly

compensation per employee should be deposited in their account and not be paid in cash. Total compensation should not exceed government mandated requirements for the job.

Management agreed to provide management and staff with a single salary.

## **7. Implement and enforce proper project accounting controls and recordkeeping.**

Accounting and recordkeeping for FMSP is extremely poor, which facilitated many of the problems noted in this report.

A system of project accounting should be immediately implemented, used and enforced. This system should monitor and ensure:

- total cost of each project is maintained within project limits,
- projects are completed on time,
- the work meets quality requirements,
- materials are received on time,
- completed contract is signed off by contractor, Ministry and beneficiary,
- beneficiaries and projects are not budgeted for more than once,
- the status of each project is immediately and clearly apparent from the records,
- project ledger is balanced monthly to the books of the Ministry,
- discrepancies are followed up on time,
- unreliable vendors are monitored and prevented from participating in future projects,
- projects are evaluated and signed off by staff independent of the Ministry.

Management concurred with the finding and agreed to corrective action.

## **8. Improve controls over the selection of beneficiaries and regions.**

### Selection of Beneficiaries

The process for selecting beneficiaries is weak and, therefore, vulnerable to manipulation. Although the law lists the qualification criteria, the process is diluted in actual practice. The Regional Coordinators of FMSP nominate a list of recipients from their responsible area. The list is approved by FMSP. The FMSP construction engineer visits, but the actual specification of materials is usually prepared by the local coordinator. Proof that the house was devastated is the only requirement to qualify. This proof consists of a certificate issued by the construction engineer. There is no prioritization when more aid is required than is available. In addition, there are no rules concerning multiple members of the same family who live in the same house and may get multiple donations for the same house.

The replacement procedure is also weak. During our visit to one local regional center, we examined a list of five people to be replaced with new candidates. When we asked, staff told us they were being replaced since they had sold or exchanged their



houses/apartments and were no longer eligible. We tested this explanation by selecting one of the five individuals and contacting him. The individual denied that the apartment had been sold and did not want to be taken off the recipient list.

We recommend the law and procedures be reviewed and updated to include specific processes for independent review of eligible individuals. We also recommend the policy include a specific process for assigning priority. Individuals should not be taken off the recipient lists without an independent site visit, interview and follow up. In all cases materials needed for the project should be decided by someone independent of the selection and nominating process.

Strict guidelines and limits should be established concerning multiple members of the same family who live in the same premises.

Someone outside the FMSP should be assigned to follow up on complaints and to visit communities and beneficiaries on a regular basis to ensure the program is being appropriately administered and accounted for.

### Selection of Regions

Regional priorities are determined by the Minister and his Deputy. We noted some regions, which appear to be totally neglected in spite of having signed contracts, while other obligations were quickly and fully fulfilled. For example, in Prijedor, 254 beneficiaries signed self-help<sup>1</sup> contracts in October of 2001. Delivery and build by the beneficiary was to be completed within five months of signing the contract and receipt of materials. In January of 2003, over 15 months later, nothing has been received by these Prijedor residents while other contracts signed in 2002 for other regions were fully fulfilled.

We were provided with no adequate explanation for this situation other than speculation regarding political connections of top FMSP management.

Immediate steps should be taken to ensure all signed contracts are completed within the agreed upon timeframe and budget. Later contracts should not be allowed to take precedence over earlier agreements.

Management concurs with the finding and agreed to appropriate corrective action.

## **9. Ensure all funds provided directly or indirectly from the government are allocated through the budget process.**

Although this Ministry received budgetary funds as part of the annual funding process, they received additional funds from "donor" conferences. Over 99% of the funding for the Donors Conference for Srebrenica came directly or indirectly from the Federation Government. Of the 1,390,180.50 KM received, 500,000 KM came from the Federation Government, 500,000 KM came from Elektroprivreda and 300,000 KM from BH Telecom. Both companies are owned by the Government. 50,000 KM came from the Ministry and only 6,000 KM came from other sources. Donor conference funds are deposited in a separate bank account under the control of FMSP management. Therefore, there is a much lower level of control over these funds, than funds which come through the annual budget from the Ministry of Finance. Enabling the government to donate additional funds to the FMSP

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<sup>1</sup> Self-help projects only include delivery of material, while the beneficiary needs to complete construction within five months of signing the contract.

enables them to remove these funds from Treasury control and place them in bank accounts managed by FMSP management.

In order to ensure funds are appropriately budgeted, controlled and managed in a fully transparent manner, we recommend the government provide their support of this Ministry solely through the budgeting process. Additional transfers through public companies should be eliminated.

We also recommend that all funds provided to FMSP, including funds from donor conferences, be put under the same treasury system and control as the funds transferred from the budget. This process will account for all funds in the same manner, improving efficiency, transparency and control. The funds can be designated as to their purpose, which should eliminate any donor objections.

Management plans on implementing these controls with donor approval. Since 99% of the donor conference funds actually came from the Ministry, the Federation Government Federation Government -owned companies, we wish to stress that donor disapproval should not be allowed to prevent the recommend controls from being implemented.

#### **10.Consolidate all activities and project accounts for the Ministry.**

As part of our audit, we requested both the Ministry of Social Policy and the banks provide us with a complete list of all bank accounts held by the Ministry. Both the Ministry and Central Profit Bank failed to inform us of one of their donor accounts. Fehim Bekan, Secretary of the Ministry of Social Policy, authorized this account to be opened. Signatories on the account are Fehim Bekan and Deputy Minister, Mijat Tuka. The account was established with 100,000 KM donation from the Federation Government.

We believe this account was originally set up to pay for the project called S-21, which was initially established to finance the reconstruction of 23 homes in Srebrenica from donated government funds. However, the contractors for S-21 were instead paid out of the budget from the Treasury account. The bank statements showed that instead two payments were made from this donors fund to fund other projects.

This Ministry also has a number of other bank accounts for different projects. Controls over these accounts are weak and open to manipulation. We recommend all accounts be brought under strict budgetary and Treasury control. Funds donated from sources other than direct or indirect government sources can be designated and separately accounted for. However, the control systems and methods should be the same as the main account. Also, since most "donor" funds were really supplied by the Federation Government or Federation Government-owned companies, there is no reason to supply and control these funds outside the normal budgetary process.

Management concurs. See comment under No. 9 above.

#### **11.Adhere to budgets.**

In 2001 the FMSP grossly overspent their budget by over 14.3 million KM by running up liabilities. At the time of our audit the 2002 budget was overspent by at least a half million KM. The budget is prepared based on contracts to be completed during the year. Each contract is fully budgeted for. Therefore, all work on these contracts is expected to be carried out as agreed within the budget.

In spite of funds being budgeted, this Ministry has overspent their budget and still has not completed much of the work they originally budgeted for. At the end of 2002, approximately 800 houses, which were contracted for in September and October of 2001 remained incomplete. The estimated value of the incomplete work is 5.6 million KM. The majority of this overspending is the result of deliberate overriding of controls enabling excess spending with favored vendors and financial mismanagement of this Ministry. Of the houses that were built, the work quality and materials used in construction was often poor and not up to the contacted quality.

We recommend the Deputy Minister and Secretary of the Ministry be replaced and transactions with favored vendors for the past 20 months be examined by the Financial Police. In addition, financial controls to prevent overspending by running up liabilities, should be put into place by the Ministry of Finance.

Management responded by agreeing to implement appropriate budgetary control.

## **12. Adhere to Donor Conference mandates.**

In March of 2002, the Board of Donors provided a 110,664 KM loan to the FMSP to rent Sumaprojekt premises. The transaction was authorized by Mijat Tuka, Deputy Minister and Adjul Salihbegovic, Deputy to the President of the Board of Donors. Donor Conference funds are designated and are not to be used for purposes other than what is specified for the benefit of refugees and displaced persons. The loan remains outstanding.

Management will ensure the prior transactions are investigated by the appropriate authority and will issue an instruction to mandate that donor funds be restricted to the purpose for which they are intended.

## **13. Implement and enforce controls to duplication of beneficiaries.**

During our audit we noted different lists of beneficiaries contained duplicate names. For example 186,292.32 KM in benefits for 11 individuals from Zvornik was budgeted in 2002 for material for Phases I and II of construction. Ten of the same 11 individuals were again included in the BiH Donor Conference for 83,664 KM. Although this second budget was supposed to be for construction works rather than materials, there is no evidence of who and when provided materials necessary for completion of works (III and IV phases) and from which budget it was paid. The works are nearly 100% completed.

This situation existed for all projects of DS-92.

All budgets should contain detailed information as to the work to be completed including phases and detailed cost estimates as well as the beneficiary details. Failure to adequately budget, can lead to manipulation by providing funds more than once for the same beneficiary.

Management concurred and agreed to recommended actions.

## **MANAGEMENT'S RESPONSE**

A new Minister, Edin Music, was recently appointed to head this Ministry. He responded positively to the report and developed a number of specific corrective actions, which when implemented should significantly improve control. We recommend he continue to work

with OHR RRTF Donor Relations staff to further flesh out the steps and ensure they are promptly and successfully implemented.

Dale Ellen Ralph  
Special Auditor  
Appointed by the Decision of the High Representative