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ONE HUNDRED NINTH CONGRESS

Congress of the United States

House of Representatives

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March 15, 2005

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The Honorable Christopher Shays
Chairman
Subcommittee on National Security,
Emerging Threats, and International Relations
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Yesterday, Rep. Dingell and I wrote to President Bush, revealing that Halliburton's overcharges under one task order of the Restore Iraqi Oil (RIO) contract exceeded \$100 million.

Today, I am writing about evidence that Administration officials — acting at the request of Halliburton — intentionally withheld this information from international auditors in violation of U.N. Security Council Resolution 1483.

A Halliburton subsidiary, KBR, has been paid \$2.5 billion under the no-bid RIO contract. Of this amount, \$875 million came from U.S. funds and roughly \$1.6 billion came from the Development Fund for Iraq (DFI). The DFI is the successor to the U.N. Oil for Food Program. It was created in May 2003 by U.N. Security Council Resolution 1483. This resolution provided that various Iraqi funds, including the proceeds of Iraqi oil sales, should be used for the benefit of the Iraqi people. Resolution 1483 gave the U.S.-controlled Coalition Provisional Authority the authority to manage the DFI, but it required the U.S. to administer the fund "in a transparent manner." The resolution also created the International Advisory and Monitoring Board (IAMB) to oversee U.S. stewardship of the DFI.

Beginning in April 2004, the IAMB repeatedly requested information from the United States about the use of Iraqi funds in the DFI to pay for Halliburton's sole-source RIO contract. After considerable foot-dragging, the United States provided redacted versions of Pentagon audits of the RIO contract to the IAMB in October 2004. These redacted audits were also provided to the National Security Subcommittee.

I have obtained an unredacted copy of one of the audits and compared it to the redacted version provided to the IAMB and the Subcommittee. This audit examines Task Order 5, one of the five task orders relating to the importation of fuel into Iraq. It was issued by the Defense

Contract Audit Agency (DCAA) on October 8, 2004. The total value of the task order is \$887 million, \$725 million of which was paid for using DFI funds.

A comparison of the redacted version sent to the international auditors and the unredacted version reveals striking differences:

- The second line of the unredacted executive summary reads: “Our examination of the \$875,255,894 proposal disclosed \$108,409,622 in questioned costs and \$1,255,333 in unresolved costs.” The second line of the audit sent to the IAMB reads: “Our examination of the \$875,255,894 proposal disclosed [deleted] in questioned costs and [deleted] in unresolved costs.”
- The unredacted audit describes \$62 million in “unreasonable costs” related to Halliburton’s fuel imports from Kuwait and finds that “KBR did not demonstrate the prices for Kuwaiti fuel and transportation were fair and reasonable.” Both the overcharge amount and the finding of unreasonable costs are deleted in the redacted audit provided to the IAMB.
- The unredacted audit states: “KBR was unable to demonstrate the proposal was based on actual costs”; “We consider KBR’s estimating system to be inadequate”; “KBR was unable to reconcile the proposed costs to its accounting records”; “KBR did not always provide accurate information”; “KBR has failed to demonstrate adequate competition in its procurement decision”; “KBR did not comply with the stated terms and conditions of its own subcontract clauses”; and “We found significant purchasing system deficiencies.” These and many other critical findings by the DCAA auditors are absent from the audit provided to the IAMB.

The extensive redactions in the audit were apparently made at the specific request of Halliburton. A September 28, 2004, letter from Halliburton to the Army Corps of Engineers states: “we have redacted the statements of DCAA that we believe are factually incorrect or misleading and could be used by a competitor to damage KBR’s ability to win and negotiate new work.”

The withholding of this information is highly unusual and raises serious issues. A senior official at the National Archives told the Subcommittee he has “never encountered” a case in which the government redacted the amount of a company’s overcharge. An official at the nonpartisan Congressional Research Service agreed, stating that overcharge amounts are “hardly proprietary information.” The evidence suggests that the United States used Iraqi oil proceeds to overpay Halliburton and then sought to hide the evidence of these overcharges from the international auditors.

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Although there are five congressional committees investigating the U.N. Oil for Food Program, only our Subcommittee is also examining U.S. stewardship of the DFI, the successor to the Oil for Food Program. The Subcommittee has subpoenaed Federal Reserve records relating to the DFI, and you have joined with me in requesting unredacted versions of the DCAA audits sent to the IAMB. I commend you for these actions.

In light of this new evidence of misuse of DFI funds — and the apparent efforts of U.S. officials to conceal the extent of the overcharges — I request that the Subcommittee take three additional steps: (1) subpoena all DCAA audits of Halliburton’s RIO contract and other contracts involving DFI funds; (2) subpoena all documents held by Halliburton or the Department of Defense relating to the IAMB; and (3) schedule a prompt hearing on U.S. management of the DFI with testimony from Administration officials, including the DCAA auditors who prepared the RIO audits, the Defense Department officials responsible for reviewing Halliburton’s redactions and submitting the audits to the IAMB, the Corps of Engineers officials who are responsible for recovering the overcharges, and the Special Inspector General for Iraq Reconstruction.

The Development Fund for Iraq

The Development Fund for Iraq is the successor to the U.N.’s humanitarian Oil for Food Program, which was intended to provide for the basic needs of Iraqis while U.N. sanctions were in effect. On May 22, 2003, U.N. Security Council Resolution 1483 formally transferred control of the Oil for Food assets to the DFI and placed them under the authority of the U.S.-controlled Coalition Provisional Authority (CPA). In addition to funds from the Oil for Food Program, the DFI also received the proceeds from the sale of Iraqi oil, as well as repatriated funds and foreign donations.

The Security Council required the United States to use DFI funds “in a transparent manner to meet the humanitarian needs of the Iraqi people . . . and for other purposes benefiting the people of Iraq.”¹

To ensure that the United States administered the DFI in compliance with this requirement, the Security Council created the International Advisory and Monitoring Board (IAMB) to oversee U.S. stewardship of the DFI. The IAMB is comprised of members representing the United Nations, the International Monetary Fund, the World Bank, and the Arab Fund for Social and Economic Development.² The IAMB was envisioned as the primary vehicle for guaranteeing the transparency of the DFI and for ensuring that DFI funds are used properly.

¹ United Nations Security Council Resolution 1483 (May 22, 2003).

² *Id.*

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According to U.N. Secretary General Kofi Annan, the IAMB was intended to act as the “eyes and ears of the international community.”³

When the United States assumed responsibility for these funds, it explicitly agreed to these terms. As CPA Memorandum Number 4 stated:

As steward for the Iraqi people, the CPA will manage and spend Iraqi Funds, which belong to the Iraqi people, for their benefit [T]hey shall be managed in a transparent manner that fully comports with the CPA’s obligations under international law, including Resolution 1483.⁴

During CPA’s administration of the DFI, a total of \$20.6 billion was deposited into the account.⁵ By June 28, 2004, the United States had committed approximately \$19.7 billion of this total.⁶

The RIO Contract

The single largest private recipient of Iraqi oil proceeds under the DFI was Halliburton, which received roughly \$1.6 billion in DFI funds under its sole-source oil infrastructure contract with the U.S. Army Corps of Engineers.⁷

On March 8, 2003, the U.S. Army Corps of Engineers awarded Halliburton subsidiary KBR a no-bid monopoly contract to restore and operate Iraq’s oil infrastructure. Under the Restore Iraqi Oil contract, the Defense Department issued ten different task orders to Halliburton for the importation of fuel for the Iraqi people, the preparation of damage assessments, and the repair of oil facilities.

³ International Advisory and Monitoring Board, *Minutes of the Organizational Meeting* (Dec. 5, 2003).

⁴ Coalition Provisional Authority, *Memorandum No. 4: Contract and Grant Procedures Applicable to Vested and Seized Iraqi Property and the Development Fund for Iraq* (Aug. 19, 2003).

⁵ Coalition Provisional Authority, *Development Fund for Iraq: Financial Reporting Matrix* (June 26, 2004).

⁶ *Id.*

⁷ U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Oct. 7, 2004) (online at <http://www.hq.usace.army.mil/CEPA/Iraq/March03-table.htm>).

Halliburton has charged approximately \$2.5 billion under the RIO contract, which had a potential value of \$7 billion.⁸ This is a “cost-plus” contract, meaning that Halliburton’s costs are fully reimbursed, and the company receives an additional award of 2% to 7% of these costs.

Task Orders 1, 2, 3, 4, and 6 under the RIO contract related to various oil infrastructure projects, while Task Orders 5, 7, 8, 9, and 10 involved the importation of fuel from Kuwait, Turkey, and Jordan. The majority of Halliburton’s charges under this contract were for fuel importation and distribution: Halliburton charged approximately \$1.5 billion for fuel work and \$1 billion for infrastructure work.

There were two sources of funding for this work: approximately \$875 million came from U.S. taxpayer funds and \$1.64 billion came from seized Iraqi assets and Iraqi oil proceeds in the U.S.-controlled Development Fund for Iraq.⁹ Nearly all of the fuel importation work was paid for with Iraqi funds. For example, Task Order 5 was funded with \$72 million in U.S. funds and \$815 million in Iraqi funds.¹⁰

IAMB Requests for the Audits

IAMB officials repeatedly sought information from the United States about Halliburton’s no-bid RIO contract. According to minutes from the IAMB’s meeting on March 17, 2004, for example, the IAMB learned that “some contracts using DFI funds were awarded to Halliburton without competitive bidding.”¹¹ Although the IAMB recognized that “exceptional circumstances” may have justified such awards, it “decided to consider further steps, such as the conduct of a special audit of some of the sole-sourced contracts.”¹² The IAMB directed its private accountant, KPMG, “to pay special attention” to this issue.¹³

Mr. Jean-Pierre Halbwachs, the Chairman of the IAMB and the Assistant Secretary General and Controller of the United Nations, sent a written request to Ambassador Bremer on April 5, 2004, asking for “further information on all sole-sourced contracts paid for using DFI funds,” including “contracts amounting to \$1.4 billion [that] were awarded to Halliburton.”¹⁴

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ International Advisory and Monitoring Board, *Minutes of Meeting* (Mar. 17–18, 2004).

¹² *Id.*

¹³ *Id.*

¹⁴ Letter from Jean-Pierre Halbwachs, Chairman, International Advisory and Monitoring Board, to Ambassador L. Paul Bremer, III, Administrator, Coalition Provisional Authority (Apr. 5, 2004).

The IAMB Chairman also specifically requested copies of “a number of audits relating to these contracts” conducted by the U.S. government.¹⁵

Nearly three weeks later, at its April 23, 2004, meeting, the IAMB reported that it had “followed up with the CPA on its earlier request to access audits of sole-sourced contracts funded by the DFI, including those by the Defense Contract Audit Agency.”¹⁶ In response, the CPA claimed that it was “liaising with U.S. government agencies to obtain copies of the audit reports.”¹⁷ The IAMB again asked the CPA “to provide the audit reports expeditiously.”¹⁸

Another month later, on May 24, 2004, the IAMB reiterated “earlier requests by the Board to obtain audit reports regarding sole source contracts, including those by the Defense Contract Audit Agency.”¹⁹ In a briefing to the IAMB on the first stages of its work, KPMG acknowledged that it experienced “difficulties” with CPA officials.²⁰ The IAMB issued a press release after the meeting, stating that it “looks forward to the imminent receipt of the audits on sole-sourced contracts being conducted by U.S. government agencies.”²¹ CPA responded that it would provide the DCAA reports “as soon as clearance from the concerned parties with regards to proprietary information is finalized.”²²

The IAMB issued a statement on June 22, 2004, criticizing the CPA’s lack of cooperation. According to the statement: “The IAMB regrets, despite its repeated requests, the delay in receiving reports on audits undertaken by various agencies on sole-sourced contracts funded by the DFI.”²³

Administration officials continued to resist the IAMB requests for several more months. In a September 8, 2004, statement, the international auditors explained that they had “not received reports on audits undertaken by various U.S. agencies on sole-sourced contracts, despite

¹⁵ *Id.*

¹⁶ International Advisory and Monitoring Board, *Minutes of Meeting* (Apr. 22–23, 2004).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ International Advisory and Monitoring Board, *Minutes of Meeting* (May 24–25, 2004).

²⁰ *Id.*

²¹ International Advisory and Monitoring Board, *Statement by the International Advisory and Monitoring Board* (May 25, 2004).

²² International Advisory and Monitoring Board, *supra* note 19.

²³ International Advisory and Monitoring Board, *Statement by the International Advisory and Monitoring Board* (June 22, 2004).

repeated requests.”²⁴ They said that “[t]he IAMB expressed its strong concern with these delays that hamper fulfillment of its mandate.”²⁵

The Administration finally provided the IAMB with “redacted copies of the DCAA audit reports on sole sourced contracts at its meeting in October 2004.”²⁶

Information Withheld from the IAMB

I have obtained an unredacted copy of the audit of Task Order 5, Halliburton’s largest RIO task order.²⁷ A comparison of the redacted version of this audit sent to the IAMB and the unredacted version I have obtained reveals striking differences. In sum, it appears that the Administration intentionally withheld crucial but embarrassing audit findings, including the amount of Halliburton’s overcharges under the RIO contract, from the IAMB.

The version of the audit sent to the IAMB includes a complete redaction of Halliburton’s overcharge amounts. For example, the second line of the audit’s executive summary was redacted to eliminate the reference to “\$108,409,622 in questioned costs.”²⁸ Other key overcharge figures were also redacted, including:

- \$62 million in “unreasonable costs” related to fuel imported from Kuwait,²⁹
- \$27 million in charges that were not included in Halliburton’s schedule of “actual costs”,³⁰ and
- \$17 million in unwarranted retroactive increases in payments to subcontractors importing fuel from Turkey.³¹

²⁴ International Advisory and Monitoring Board, *Statement by the International Advisory and Monitoring Board* (Sept. 8, 2004).

²⁵ *Id.*

²⁶ International Advisory and Monitoring Board, *Report of the International Advisory and Monitoring Board of the Development Fund for Iraq* (Dec. 14, 2004).

²⁷ Defense Contract Audit Agency, *Audit Report No. 3311-2004K17900055* (Oct. 8, 2004).

²⁸ *Id.* at 1.

²⁹ *Id.* at 2, 10.

³⁰ *Id.* at 2, 11.

³¹ *Id.* at 2–3.

Throughout the version of the audit sent to the IAMB, crucial auditor findings regarding the reasonableness of Halliburton's prices and the continued deficiencies in the company's systems were also blacked out. The redacted findings included:

- “KBR did not demonstrate the prices for Kuwaiti fuel and transportation were fair and reasonable.”³²
- “The data provided did not reconcile to KBR's accounting records, and KBR was unable to demonstrate the proposal was based on actual costs.”³³
- “KBR was unable to reconcile the proposed costs to its accounting records.”³⁴
- “Our audit found purchase orders and procurement files related to the Kuwait supplier did not contain data to support the reasonableness of the negotiated purchase orders.”³⁵
- “Because the noncompliances and inadequacies are considered significant, we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price.”³⁶
- “KBR did not always provide accurate information.”³⁷
- “KBR has failed to demonstrate adequate competition in its procurement decision.”³⁸
- “Throughout our audit of [Task Order] 5, we requested data from KBR supporting its analysis of the competitive bids and/or price analyses for the Kuwait fuel and transportation costs. We did not receive the requested data.”³⁹
- “KBR did not comply with the stated terms and conditions of its own subcontract clauses.”⁴⁰

³² *Id.* at 1.

³³ *Id.* at 1.

³⁴ *Id.* at 11.

³⁵ *Id.* at 2.

³⁶ *Id.* at 5.

³⁷ *Id.* at 12.

³⁸ *Id.* at 16.

³⁹ *Id.* at 11.

- “We consider KBR’s estimating system to be inadequate.”⁴¹
- “We found significant purchasing system deficiencies during related audits.”⁴²

Without any overcharge figures or key audit findings, the redacted audits were essentially useless to the international auditors charged with monitoring U.S. disbursements of DFI funds. After examining the redacted audits, Mr. Halbwachs, the chair of the IAMB, reported that “it was impossible to determine the extent of alleged overcharges because the figures had been redacted.”⁴³

Halliburton’s Role in the Redactions

These extensive redactions were apparently made at the specific request of Halliburton. On September 28, 2004, Halliburton sent a letter to the Corps of Engineers describing how the company had redacted DCAA audits for transmission to the IAMB. This letter concerned the redactions of Task Order 9, but its language appears to apply to all of the DCAA audits.

The letter indicates that Halliburton’s KBR subsidiary made two types of redactions. First, the letter states that “KBR has redacted the information that KBR considers to be a disclosure of its proprietary policies, procedures, and accounting information.”⁴⁴ These were not the only redactions requested by KBR, however. The letter also states that “we have redacted the statements of DCAA that we believe are factually incorrect or misleading and could be used by a competitor to damage KBR’s ability to win and negotiate new work.”⁴⁵

Another letter, dated October 5, 2004, shows that Halliburton made redactions to each of the audits. In this letter, KBR “agrees to the release to the United Nations of the full Defense Contract Audit Agency (DCAA) reports ... in redacted form as contained in the referenced letters. This consent applies only to release to the United Nations.”⁴⁶

⁴⁰ *Id.* at 18.

⁴¹ *Id.* at 3, 26.

⁴² *Id.* at 27.

⁴³ *U.N. Board Cites U.S. Contractor in Iraq*, Washington Post (Dec. 15, 2004).

⁴⁴ Letter from Michael K. Morrow, Contracts Manager, KBR, to Gordon A. Sumner, Contracting Officer, U.S. Army Corps of Engineers (Sept. 28, 2004).

⁴⁵ *Id.*

⁴⁶ Letter from Michael K. Morrow, Contracts Manager, KBR, to Gordon A. Sumner, Contracting Officer, U.S. Army Corps of Engineers (Oct. 5, 2004).

Expert Views on the Redactions

According to independent experts, both the redactions and the process by which they appear to have been made would be improper.

Administration officials have justified the extreme redactions on the ground that the amounts of Halliburton's overcharges were proprietary business information. According to the IAMB, the Administration "informed the IAMB that portions of the reports had been redacted by the DCAA to safeguard proprietary information of the concerned parties."⁴⁷ A Pentagon spokesperson called the overcharge figures "proprietary in nature."⁴⁸

This claim appears to be untenable. Earlier this month, J. William Leonard, the Director of the Information Security Oversight Office of the National Archives and Records Administration, testified before the Subcommittee that he has "never encountered" a case in which the government has withheld as proprietary business information the actual amount a company overcharged the government, as determined by government auditors.⁴⁹ Mr. Leonard also said that he "would be hard pressed to readily come up with a rationale" for such a withholding.⁵⁰ Harold C. Relyea of the nonpartisan Congressional Research Service agreed, stating: "It's hardly proprietary information."⁵¹

The Pentagon itself previously treated overcharge amounts as public information. At a December 11, 2003, press conference, DCAA officials publicly announced their preliminary findings of a \$61 million overcharge by Halliburton for the gasoline imported from Kuwait.⁵² Similarly, the Government Accountability Office (GAO) has published detailed information about Halliburton's past overcharges. In a February 1997 report, GAO presented specific cost estimates and inflated prices charged for Halliburton's work in Bosnia, including, for example, Halliburton's exact price for plywood.⁵³

⁴⁷ International Advisory and Monitoring Board, *supra* note 26.

⁴⁸ *U.N. Board Cites U.S. Contractor in Iraq*, Washington Post (Dec. 15, 2004).

⁴⁹ Subcommittee on National Security, Emerging Threats, and International Relations, *Hearings on Emerging Threats: Overclassification and Pseudo-Classification*, 109th Cong. (Mar. 2, 2005).

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² U.S. Department of Defense, *News Briefing* (Dec. 11, 2003).

⁵³ General Accounting Office, *Contingency Operations: Opportunities to Improve the Logistics Civil Augmentation Program* (Feb. 1997).

Testimony from Mr. Leonard and Mr. Relyea also shows that it would be inappropriate for the government to adopt a company's redactions without making its own assessment about the validity of those redactions. Both agreed that it would be improper for an agency to abdicate the responsibility to make its own assessment. Mr. Relyea characterized an agency's uncritical acceptance of a company's redactions as "a terrible abrogation of responsibility."⁵⁴

Typically, government officials are required to review a contractor's suggested redactions and exercise their own independent judgment about whether they are valid. For example, under the Freedom of Information Act (FOIA), after an agency gives a company an opportunity to submit redactions of what it believes is confidential commercial information, the "agency shall give careful consideration to all such specified grounds for nondisclosure prior to making an administrative determination of the issue."⁵⁵

Under these standards, it is improper to redact core auditor findings purely because the contractor disagrees with them. When asked if a contractor's disagreement with an auditor's conclusion would be a valid reason to redact the conclusion, Mr. Leonard responded, "Not from my experience."⁵⁶ There is, of course, no FOIA disclosure exemption for embarrassing information that a company would rather not have disclosed.

Conclusion

For many months, five separate congressional committees have been investigating the failings of the U.N. Oil for Food Program in minute detail. While a responsible investigation of the U.N.'s management of this program is important, Congress also has an obligation to investigate any mismanagement of the DFI, the U.S.-controlled successor of the Oil for Food Program from which billions of dollars were disbursed. In fact, we arguably have a greater obligation to oversee the DFI than the Oil for Food Program given that the DFI was under U.S. control.

Under your leadership, the Subcommittee has taken important steps to provide oversight of the DFI. The Subcommittee has subpoenaed relevant Federal Reserve records, and you have joined me in requesting unredacted copies of the DCAA audits. In light of the new evidence of overpayments to Halliburton using DFI funds, I request that the Subcommittee take three additional steps: (1) subpoena all DCAA audits of Halliburton's RIO contract and other contracts involving DFI funds; (2) subpoena all documents held by Halliburton or the Department of Defense relating to the IAMB; and (3) schedule a prompt hearing on U.S.

⁵⁴ Subcommittee on National Security, *supra* note 49.

⁵⁵ Exec. Order No. 12600, 52 Fed. Reg. 23781 (June 23, 1987).

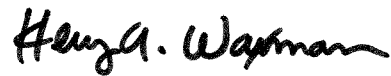
⁵⁶ Subcommittee on National Security, *supra* note 49.

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management of the DFI with testimony from Administration officials, including the DCAA auditors who prepared the RIO audits, the Defense Department officials responsible for reviewing Halliburton's redactions and submitting the audits to the IAMB, the Corps of Engineers officials who are responsible for recovering the overcharges, and the Special Inspector General for Iraq Reconstruction.

I commend you for the steps you have taken and look forward to working with you on this important matter.

Sincerely,

A handwritten signature in black ink that reads "Henry A. Waxman". The signature is written in a cursive, flowing style.

Henry A. Waxman
Ranking Minority Member