

**STATEMENT OF STUART W. BOWEN, JR.
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BEFORE THE

**UNITED STATES HOUSE
OVERSIGHT AND GOVERNMENT REFORM COMMITTEE**

UNITED STATES' INVOLVEMENT IN IRAQ RECONSTRUCTION

**Tuesday, February 6, 2007
Washington, D.C.**

Chairman Waxman, Ranking Member Davis, and members of the Committee: thank you for this opportunity to testify again before you on the United States' involvement in Iraq reconstruction. Specifically, I will address my Office's January 30, 2005 audit report on the *Oversight of Funds Provided to Iraqi Ministries through the National Budget Process* (SIGIR Report No. 05-004), which addresses the Coalition Provisional Authority's (CPA) financial and managerial controls over \$8.8 billion from the Development Fund for Iraq (DFI) that the CPA disbursed to Iraqi ministries. I look forward to a productive exchange with the Committee regarding this audit and SIGIR's other work in Iraq.

BACKGROUND

I was appointed Inspector General of the Coalition Provisional Authority (CPA-IG) in late January 2004 and immediately began to staff and develop the organization and to structure an oversight plan for the Coalition Provisional Authority's programs and operations. My Office's first Quarterly Report was released on March 30, 2004. I deployed my first contingent of auditors to Iraq at the end of March 2004, just a few months before the June 28 dissolution of the CPA.

In October 2004, two months before the scheduled termination of the CPA-IG, the Congress passed legislation to continue my Office's the oversight function, redesignating it as the Special Inspector General for Iraq Reconstruction (SIGIR). The Congress also extended SIGIR's oversight to the entire \$21 billion Iraq Relief and Reconstruction Fund (IRRF). The Congress extended SIGIR's mandate again in December 2006, providing my Office oversight authority over all FY 2006 reconstruction funding.

Pursuant to its enabling authority, SIGIR reports jointly to the Secretaries of State and Defense on U.S. reconstruction programs and operations. Importantly, where our reports find problems, they provide lessons learned and potential approaches for corrective action. Further, SIGIR distributes all reports directly to the Congress and makes them available to the public on our website, www.sigir.mil.

To execute their mission, SIGIR auditors apply a balanced review, providing oversight, insight, and foresight for the Iraq reconstruction program. SIGIR's *oversight* efforts, an IG's traditional focus, address whether the U.S. taxpayer investment was properly

executed pursuant to mandated legal requirements. This promotes transparency and accountability within the U.S. reconstruction effort. SIGIR's *insight* efforts advise the U.S. leadership on ongoing management issues identified in the course of SIGIR's work. SIGIR's *foresight* efforts focus on assisting management in achieving identified goals, such as effective transition of programs, sustainment of projects, and capacity building within Iraqi ministries.

IMPACT OF SIGIR'S WORK

To date, SIGIR has:

- Produced 12 Quarterly Reports.
- Issued 82 audit products and has another 14 audits underway. Of note, SIGIR maintains an ongoing follow-up program that tracks management response to our audit recommendations. We recently published a comprehensive follow-up report that found that U.S. agencies in Iraq have implemented 34 of the 40 recommendations we made to improve the transparency and accountability of the DFI.
- Produced 80 project assessments based on inspections of project sites. The most significant for this quarter was our second assessment of the Baghdad Police Academy.
- Opened 300 criminal and civil investigations leading to five arrests and convictions, including the recent conviction of Robert Stein, who was sentenced to nine years in prison and fined \$3.6 million for his role in money laundering and conspiracy to defraud the CPA in Hilla, Iraq. SIGIR Investigations have resulted in another 23 cases currently under prosecution at the Department of Justice, and we are currently working on 76 on-going investigations.

SIGIR also has a robust Lessons Learned Program, with two reports already published (one on Human Capital Management and the other on Contracting). The third and final report, which addresses Program and Project Management, will be published this quarter. A Lessons Learned capping report, called The Story of Iraq Reconstruction, will be published by the end of this calendar year.

SIGIR's work has produced direct and indirect financial benefits to the American taxpayer and the government of Iraq, as well as improvements in the overall management of the Iraq reconstruction effort, including:

1. SIGIR audits have saved or recovered \$50 million, identified better use of \$7.8 million, and identified the potential to recover \$106 million.
2. SIGIR investigations have recovered or seized assets amounting to \$9.5 million, and are working on the recovery of an additional \$15 million.
3. SIGIR inspections made recommendations to ensure the effective use of an estimated \$39 million in reconstruction projects.

4. SIGIR enabled U.S. reconstruction management officials to:
 - a. Improve efficiency/effectiveness and reduce expenditures;
 - b. Implement or improve fund and asset controls;
 - c. Enhance construction quality by ensuring adequacy of design specifications, stopping inadequate construction, and avoidance of re-work; and
 - d. Avoid waste and unnecessary expenditures.

SIGIR inspectors also found that engineering improvements to oil pipelines could increase oil export volume, and potentially increase Iraqi oil revenues by more than \$1 billion annually if the pipeline can be effectively secured.

[SIGIR's latest quarterly report is submitted for the record, January 31, 2007, at <http://www.sigir.mil/reports>]

Oversight of Funds Provided to Iraqi Ministries through the National Budget

This audit report, which was accomplished during the late spring and early summer of 2004 and published on January 30, 2005, was the result of an audit SIGIR initiated to determine whether the CPA's implemented sufficient controls over DFI funds provided to the Interim Iraq Government (IIG) ministries through the national budget process. The audit concluded that CPA failed to implement adequate controls.

Audit Scope and Process

The audit arose out of concerns that were brought to my attention (during my first two visits to Iraq) by personnel who worked in the CPA Comptroller's Office. I discussed these concerns with my Assistant Inspector General for Audit and consequently the audit was initiated, with my most experienced auditors assigned to it.

The scope of the audit covered a selected period of CPA's oversight of DFI funds and entailed the extensive documentary review as well as many interviews with the key personnel involved in managing the DFI. Specifically, my staff interviewed or obtained statements from 38 CPA advisors to 10 different IIG ministries, as listed below by ministry:

Ministry of Finance

1. George Wolfe, Senior Advisor
2. David Oliver, CPA Director Office of Management and Budget (OMB) and Senior Advisor
3. Rodney Bent, CPA Co-Director OMB and Senior Advisor
4. Colonel Mulhern, Chief of Staff
5. John Hanley, Advisor
6. Brendan Lund, Advisor
7. Anita Greco, Advisor
8. Josh McCallum, Advisor

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9. Pietro Toigo, Advisor
10. John Moore, Advisor

Ministry of Interior

11. Steve Castille, Senior Advisor
12. Steve Smith, Advisor
13. Rudy Vandaile-Kennedy, Advisor
14. Jim Vickery
15. Scott Erwin
16. Dan Jones
17. Geoff Howard
18. Mike Whitney

Ministry of Transportation

19. Captain Manson Brown, Senior Advisor
20. Doug Webster, Finance Advisor
21. Steve Myrow, Chief of Staff

Ministry of Communications

22. Jerry Thames, Senior Advisor
23. John Weaver, Chief of Staff
24. John Lyons, Finance Advisor

Ministry of Education

25. Todd Givens, Senior Advisor
26. Pam Riley, Senior Consultant

Ministry of Housing and Construction

27. Roliff Purrington, Senior Advisor
28. Doug Hageman, Chief of Staff and Budget Advisor

Ministry of Defense

29. David Gompert, Senior Advisor, National Security
30. Fred Smith, Advisor
31. Mr. Bendix, Finance Advisor

Ministry of Oil

32. Mike Stinson, Senior Advisor
33. Gary Vogler, Advisor
34. Robert McGuire, Counsel

Ministry of Labor and Social Affairs

35. Bob Gross, Senior Advisor
36. Maj. Martha Boyd, Chief of Staff and Advisor
37. Al Pino, Advisor

Ministry of Health

38. David Walker, Senior Consultant

My staff also interviewed the CPA Administrator, after he had reviewed an early draft of the audit.

Background

The CPA was the authority responsible for the temporary governance of Iraq from May 16, 2003, through June 28, 2004. The DFI was established during May 2003 by the power delegated by the President of the United States, pursuant to the approval of United Nations (UN) Security Council Resolution 1483, and the President assigned responsibility for managing the fund to the CPA Administrator.

The DFI consisted of:

- (1) funds in bank accounts with the Federal Reserve Bank of New York and the Central Bank of Iraq;
- (2) proceeds from export sales of petroleum, petroleum products, and natural gas from Iraq;
- (3) surplus funds from the UN Oil for Food program; and
- (4) funds and financial assets of the former Iraqi regime that were frozen and transferred by UN member states.

Consistent with UN Resolution 1483, the DFI was to be used in a transparent manner to meet the humanitarian needs of the Iraqi people, for the economic reconstruction and repair of Iraq's infrastructure, for the continued disarmament of Iraq, for the costs of Iraqi civilian administration, and for other purposes benefiting the people of Iraq.

On May 9, 2003, the President designated Ambassador Bremer as his Presidential Envoy to Iraq, with responsibility for overseeing the use of Iraqi state or regime-owned property under U.S. possession made available to assist the Iraqi people and support the recovery of Iraq. Because of its responsibility, the CPA was obligated to provide the management oversight and controls required to ensure that DFI funds were used for their intended purposes.

The CPA had a fiduciary responsibility to manage the DFI for the benefit of the Iraqi people in accordance with UN Resolution 1483. To that end, CPA implemented Regulation Number 2 on June 10, 2003. This regulation enumerated the CPA's responsibilities for overseeing and controlling the establishment, administration, and use of the DFI for the benefit of the Iraqi people. The CPA subsequently published further guidance further detailing procedures and processes for controlling disbursements of monies from the fund.

The CPA took the position that expenditures by Iraqi ministries were to be managed by the Iraqis and overseen by the Iraqi Interim Government. Thus, the CPA assumed a

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supervisory role and delegated to the Iraqi ministries the duty to manage and execute the budgets approved by the Administrator and allocated to them by the CPA Comptroller. This approach assumed that the IIG ministries had sufficient capacity to carry out these duties and presumed that the CPA was adequately staffed to provide sufficient supervision of the ministries budget execution.

Audit Findings

As a preliminary matter, our audit report did not say that the CPA lost taxpayer money, as some have reported, nor did it allege or imply that U.S. officials had engaged in any fraudulent practices. The DFI was not US money, but was composed of funds derived from the sale of Iraqi oil. The audit did conclude, however, that the CPA's internal controls for approximately \$8.8 billion in DFI funds disbursed to Iraqi ministries through the national budget process failed to provide sufficient accountability for the use of those funds. As noted in the report, the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner. Consequently, there was no assurance that funds were used for the purposes mandated by the United Nations Security Council Resolution 1483.

Managerial Controls

The CPA approach to managing DFI funds may have been sufficient if the CPA had some assurance that the Iraqi ministries had controls in place to effectively manage the disbursement of funds. We found that, although questions were raised about the ministries' ability to effectively manage DFI disbursements, the CPA did not properly review the internal controls in the Iraqi ministries.

In June 2003, the International Monetary Fund (IMF) provided preliminary observations to CPA officials which noted that addressing budget execution was more urgent than addressing budget planning. Further, an October 2003 IMF assessment indicated that the implementation of the budget by the Iraqi ministries would require a strengthening of payment and accounting functions, procurement procedures, and internal and external audit functions.

The International Advisory and Monitoring Board on Iraq, established by the UN to provide oversight of the DFI, conducted a review of DFI operations through the end of December 2003 (through KPMG) that found inadequate controls at Iraqi spending ministries including:

- (1) the absence of reconciliation procedures for transfers between ministries and for bank accounts;
- (2) inadequate accounting records;
- (3) deviations from the tendering procedures designed to ensure competitive bidding; and
- (4) insufficient payroll records.¹

¹ UN Security Council Resolution 1483 required independent external audits of the administration of the DFI by the CPA. KPMG, a multinational accounting firm, was hired to conduct these audits.

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In his comments to our audit report, the CPA Administrator similarly recognized such weaknesses within the IIG ministries, noting that the Iraqi government budget and personnel records, already inadequate before the war, had been destroyed by looting and willful criminal sabotage.

KPMG's report to the IAMB also identified personnel problems within CPA as a main finding, noting that there was a lack of clearly defined roles and responsibilities as well as a high turnover of CPA personnel. CPA-IG's first audit was on CPA personnel management, identifying a number of weaknesses. SIGIR's subsequent Lessons Learned Report on Human Capital Management, issued in February 2006, explicated these issues in detail.

Numerous CPA advisors, who were assigned to oversee and assist the ministries, reported to us that there were not enough experienced people to do the job they were tasked to do. For example, a CPA advisor to the Ministry of Finance stated that the CPA's biggest problem was understaffing and the government simply did not staff the organization properly. A senior CPA advisor to the same ministry described the staffing shortage as follows:

CPA Ministry of Finance/OMB is facing a critical shortage of staff. As a result, we are no longer able to keep up with the daily CPA tasks and conduct business with the Ministry of Finance at the same time—let alone make progress with capacity building... This is mission critical—finance is the lifeblood of the economy. If it isn't working, we will not succeed in our mission... Today, OMB has 12 of the 55 authorized billets filled. Of these 12, currently there are 9 available for daily operations (two on leave, one TAD to Washington), the bulk of which are good, but inexperienced recent graduates.

Additionally, several individuals we spoke with had been in country for only a short period of time. The senior advisor to the Ministry of Housing and Construction stated that he had been in country 6 to 8 weeks and that the ministry had 4 senior advisors in the last year.

CPA's senior advisors' roles and responsibilities were not clearly articulated and conveyed to the advisors. Three advisors in the Ministry of Communications told us their responsibilities were not documented and they received no training or indoctrination. A senior consultant in the Ministry of Education stated that responsibilities were never spelled out. A senior advisor in the Ministry of Housing and Construction stated that he did not receive anything that spelled out his responsibilities. A senior advisor in the Ministry of Labor and Social Affairs stated that he was told during briefings in Washington that they would learn their responsibilities from the people in country. When he arrived in country, he was told there was no training or indoctrination. When he requested guidance from the CPA Office of General Counsel, he was told "There are no written guidelines delineating the senior advisors' role, responsibilities, and authority."

Financial Controls

The CPA did not implement adequate financial controls to ensure DFI funds were properly used. For example, there were inadequate controls pertaining to the payment of

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salaries to Iraqi employees.² Consequently, there was no assurance that funds were not provided for so-called “ghost” employees. Our interviews during the course of the audit uncovered problems in this area.

The CPA Ministry of Finance/OMB could not provide any documentation to support approximately \$17 million provided for Facilities Protective Services and Civil Defense Corps salaries in February 2004; and the CPA Advisor to the Ministry of the Interior and manager of the Facilities Protective Services program said that the Ministry was paid for 8,602 guards when only 602 could be validated. A CPA advisor to the Ministry of Finance was sufficiently concerned about payroll corruption that he submitted a formal complaint to the CPA-IG. The complaint alleged:

Of the 1.6 million government employees currently on payroll, credible estimates put the number of ghost workers at somewhere between 250,000-300,000 employees. A report from one specific state owned enterprise indicates the militia leader forcefully withholds 75% of the ghost worker’s salary as “gratitude” for their new job. The money is alleged according to the report to support the local political/religious movement which is fighting the Coalition Forces.

We referred this allegation to the Iraq Commission for Public Integrity for action.

The CPA had limited documentation on how monies were spent after disbursement to Iraqi ministries. After analyzing 10 CPA disbursements ranging from \$120 to \$900 million, we found that none of them were supported by budget spending plans and two, totaling \$616 million, were not accompanied by disbursement vouchers. Additionally, although the UN provided approximately \$2.5 billion to the DFI in Oil-for-Food funds in March and April 2004, the CPA did not update the Iraqi national budget to account for the infusion of these monies.

The CPA had a responsibility to determine whether the Iraqi ministries had basic financial controls in place prior to transferring full authority over funds to the ministries. This responsibility was mandated by the UN, acknowledged by U.S. government officials, was documented in the CPA Strategic Plan and CPA guidance. The CPA Administrator stated during the transfer of sovereignty to the Ministry of Health, which was the first Iraqi ministry to attain sovereignty, that the CPA gave full authority to the Iraqi ministries only after fundamental financial and budgetary controls were in place. However, the CPA did not review internal controls or the accounting and use of funds in the Ministry of Health prior to the transfer, and CPA officials stated they were unaware of the basis for the CPA Administrator’s statement that controls were in place.

Contractual Controls

The CPA did not adequately control DFI contracting actions. Although the CPA established procedures (in CPA Memorandum No. 4) for executing contracts using DFI funds, these procedures were not followed. In keeping with the position that

² Funds for salary payments were provided through the national budget process to the responsible Iraqi Treasury offices or the Iraqi Ministry of Finance. Coalition forces that hired the security forces (Iraqi Border Police, Iraqi Civil Defense Corps, Iraqi Armed Forces, and Facilities Protective Services) were responsible for salary payments until responsibilities were transferred to the Iraqi ministries.

expenditures by Iraqi ministries were to be managed by the IIG, the CPA allowed IIG ministries to execute contracts using DFI funds, *but only* after the CPA Contracting Activity certified the contracting procedures of the ministry were adequate to ensure the transparent use and management of DFI funds.

During the tenure of CPA, the CPA Contracting Activity only certified the contracting procedures for 2 of 26 ministries (the Ministries of Finance and Electricity). If a ministry was not certified, it was required to execute all contracts through the CPA. However, there was reporting that Iraq's ministries (and senior advisors) engaged in extensive contracting, notwithstanding the lack of authorization. The Head of the CPA's Contracting Activity told us there were no procedures in place to ensure Iraqi Ministry's complied with the CPA established contracting regulations procedures, but "*hopefully the CPA advisors are providing oversight.*"

SIGIR obtained data for contracts awarded by three IIG ministries with DFI funds (Communications, Housing and Construction, and Interior). These ministries had executed contracts using DFI funds, with one ministry (Housing and Construction) executing over 250 contracts valued at approximately \$430 million. These contracts were executed without oversight from the CPA senior advisor for the ministry and without certification from the CPA Contracting Activity that the ministry's contracting procedures were sufficient to ensure compliance with UN Security Council Resolution 1483.

Management Comments to the Report

Both the CPA Administrator and the Director of the Defense Support Office — Iraq disagreed with our conclusion that the CPA failed to provide adequate and transparent stewardship of the DFI funds disbursed to Iraqi ministries. Their overarching position was that SIGIR ignored the political and administrative environment in which the CPA was operating. However, SIGIR staff lived in that environment and recognized that these conditions required meaningful controls. The CPA should have exerted more effective controls over the financial management of the DFI funds precisely because of the chaotic situation it was confronted with in Iraq. This is underscored by the acknowledged weaknesses within the Ministry of Finance in managing the national budget, the lack of reliable budgeting or personnel records, and the corrupted payroll systems.

Regarding the political situation, the CPA Administrator asserted that our report ignored the political context of the CPA role in Iraq to transfer as much responsibility to the Iraqi ministries as soon as possible and said the report suggested that the CPA should have placed hundreds of auditors into the ministries or have CPA Senior Advisors run the ministries. The report, however, did not suggest this. The report did conclude that the CPA should have done more to fulfill its oversight responsibilities assigned under UN Resolution 1483 (and reaffirmed in an October 2003 letter from the UN Security Council Secretary-General), which stated that the CPA was responsible for establishing financial and internal control systems to ensure DFI funds were used for the purposes for which they were disbursed. Of note, this was reaffirmed in a February 2004 notification from the CPA Senior advisor to the Ministry of Finance/OMB to all senior advisors that the CPA needed to determine whether there were adequate controls in the Iraqi ministries to

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ensure DFI disbursements were received by the designated recipient and used as intended.

Recent Work on the DFI

We have continued to review U.S. oversight of the DFI funds. In 2005 and 2006, SIGIR issued 6 reports on the control and accountability for contracts, grants, and cash transactions and issued 40 recommendations for improvement. Some of these reviews led to the arrests and continued investigations that I discussed earlier.

Overall, we concluded that DFI accountability had improved. To illustrate, as of August 2006, the Joint Area Support Group-Central (JASG-C), which is responsible for administering DFI funds, spent about \$1.4 million on audit services, database development, and computer equipment to satisfy SIGIR recommendations to improve the data and financial records and transparency regarding contracts. However, JASG-C failed to effectively define the requirements, write the contract, and monitor the contractor's work. As a result, one JASG-C official stated that these databases were so limited they produced little value added. As such, SIGIR believes that while agencies are taking steps to improve oversight, more still needs to be done for them to execute their fiduciary responsibility over the DFI.

CONCLUSION

Our audit report concluded that the CPA failed to implement sufficient oversight of the DFI. Specifically, it did not follow the oversight regulations adopted for DFI management.

For example, CPA Regulation Number 2 detailed the CPA DFI responsibilities, requiring the CPA to obtain the services of an independent certified public accountant firm to ensure the fund was administered and used in a transparent manner. The CPA contract award properly required the contractor to ensure the fund was administered and used in a transparent manner and for the purposes intended. By the time we issued the SIGIR report, the contractor had stated that it would review internal processes for controlling and documenting disbursement in the Iraqi ministries. It did not, however, perform this work.

CPA Memorandum Number 4 stated that part of the CPA's oversight responsibility was to ensure that funds were used for their intended purpose and that the CPA Comptroller and the Head of the CPA Contracting Activity must review contracting actions of interim Iraqi ministries. However, significant contracting by ministries was executed beyond the purview of CPA's contracting office. The CPA's own Strategic Plan called for reviews of Iraqi budget expenditure and control systems; but we found no evidence that this was accomplished.

In July 2004, a CPA/ Ministry of Finance advisor provided comments on our report and agreed with our findings. The advisor concluded that the SIGIR report:

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is appropriately critical of CPA and its handling of the Iraqi finances. They are correct to identify staffing and turnover as significant issues. As a result, standard operating procedures and adequate controls were never sufficiently implemented because the limited number of people in our office were busy doing rather than writing about doing.

Though critical of the report in not accounting for the operational environment in Iraq, the official nevertheless concluded that:

the decision was made at the highest levels within CPA (and perhaps beyond Iraq) to let the Iraqis manage their own money. This decision was made knowing the Coalition would sacrifice 100% transparency and accountability of spending. What it would do is help promote independent Iraq operations in light of the aggressive one year transition timetable. We now find ourselves in the foreseeable situation where we do not have 100% accounting of the monies spent.

In conclusion, I would like to reiterate that SIGIR remains committed to supporting the reconstruction efforts in Iraq by identifying ways to accomplish the mission more effectively and efficiently, and by deterring fraud, waste, and abuse of U.S. taxpayer dollars. SIGIR's 55 auditors, inspectors and investigators in Iraq will continue to carry out the duties and responsibilities as mandated by the Congress.

I remain proud of my staff's commitment and willingness to continue to serve along side our troops and the hundreds of other civilians far from their families, and in rapidly evolving circumstances. I will continue to do my best to ensure effective oversight and timely reporting, and to thereby advance the success of the Iraq reconstruction effort. Thank you for the opportunity to participate in this important hearing, and I look forward to answering any questions that the Committee may have.