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BEFORE THE

**UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS, AND
INTERNATIONAL RELATIONS**

**HEARING ON
IRAQ: PRECEPTIONS, REALITIES AND COST TO COMPLETE**

**Tuesday, October 18, 2005
Washington, DC**

Introduction

Mr. Chairman, Ranking Member Kucinich, and members of the Committee -- thank you for the opportunity to address you today on important matters regarding the United States' role in the reconstruction of Iraq and the oversight provided for the reconstruction program by my Office, the Special Inspector General for Iraq Reconstruction, or SIGIR. I hope for a productive exchange of views in today's hearing and that we will shed light on the issues now confronting the leadership of the Iraq reconstruction program.

This hearing is timely, coming as it does just 12 days before the release of our next Quarterly Report, which will provide reporting on a series of new audits, inspections, and investigations. Your emphasis on the costs to complete reconstruction projects parallels our focus on this important matter. It is the subject of audits reports that we will soon release and are discussed extensively the Quarterly Report, which will be delivered to you on October 30th.

We are encouraged by reports by the Department of State of steady, significant progress in Iraq, despite the widespread dangers imposed by a lethal security environment, the tensions of highly charged political climate, and the dangers of operating in a war zone.

Still, the positive facts of reconstruction remain impressive things in themselves. In sheer population served, more Iraqis now have access to potable water, to sewage services, and to electricity than ever before. More than 1,000 kilometers of roads have

been built or repaired across the last 18 months. Strategic Infrastructure Battalions are currently being trained to protect the country's infrastructure of electric grids and oil pipelines. Over 190,000 military and police have received training. Iraqi-run firms continue to compete for and win commercial contracts to develop their own country, in part because of the creation of the Provincial Reconstruction Development Committees (PRDCs). Iraq ministries now receive grants directly from international donors.

In early September, I returned from my ninth trip to Iraq since my appointment as Inspector General 21 months ago. I was encouraged by the progress that I observed during my trip. I met with Ambassador Zalmay Khalilzad and his senior reconstruction leadership in Baghdad, and found them to be aggressively exerting strategic control of the reconstruction program. They are focusing on what I see as the most important issues confronting the program now, namely, the sustainability of the infrastructure we have constructed and the effective management of remaining projects by controlling costs to complete.

The Ambassador met with me shortly before I returned stateside and made it clear that he recognizes the importance of our oversight and fully supports my office's role in Iraq. To that end, my Office, along with its ongoing oversight duties, continues to play a consultative role, serving in an advisory capacity on a number of key reconstruction working groups in Iraq.

SIGIR continues to push reconstruction management for significant, measurable progress, especially in five key areas, which I will address in my statement. These are:

(1) affordable sustainable plans that address a coordinated long-term plan for Iraq's infrastructure, as well as the need for the U.S. to provide some funds for operation and maintenance of the facilities we have built;

(2) reliable and accurate estimates of the costs to complete projects;

(3) effective information management systems;

(4) a deliberate shift to direct contracting with Iraqi companies; and

(5) the Iraqi Anti-corruption initiative.

I will elaborate on these key issues in this testimony.

The Reconstruction Gap

First, however, I would like to highlight what we see as a new area of concern: we call it the Reconstruction Gap.

We define the Reconstruction Gap as the difference between the number of projects that the U.S proposed to build when it first began committing the IRRF to programs in Iraq and the number of projects that the US will ultimately complete.

The causes of the gap include dramatically increased spending on security needs, increases in costs of materials, increased costs arising from project delays, cost overruns on particular projects, multiple reprogrammings of reconstruction priorities, and the allocation of funds for sustainment.

Though the causes may be numerous and valid, the existence of the gap simply means that the completion of the US-funded portion of Iraq's reconstruction will leave many planned projects on the drawing board.

In the coming year, the amount of money needed by the Iraqi government both to carry out the daily operations of its existing health, water, oil and electrical infrastructure, as well as to complete and sustain planned reconstruction projects, will outstrip the available revenue. The gap will need to be addressed by international donor funding for Iraq reconstruction, as well as better budgeting practices on the part of the Iraqis.

The existence of this gap may subject the U.S. to criticism for not fulfilling what was perceived as a promised number of projects. We will soon announce an audit to identify the particulars of the Reconstruction Gap.

To understand the nature of the Reconstruction Gap, let me begin with the needs.

Forty years ago, Iraq was one of the most advanced nations in the Middle East. Self-sufficient in agriculture, it had a vibrant private sector with a highly educated and skilled population, and tremendous oil wealth. Today, Iraq has descended dramatically, to a country with some of the most tragically alarming development indicators in the region.

In October 2003, the World Bank estimated that about \$56 billion would be needed to reconstruct the infrastructure of Iraq, noting that Iraq's needs

"... are vast and are a result of nearly 20 years of neglect and degradation of the country's infrastructure, environment and social services. Public resources were diverted to support the military and the ruling regime's power; poor economic and policy decisions took a toll; and conflict and international sanctions all combined to erode the standard of living for ordinary Iraqis."

This estimate did not fully take into account the additional costs for security, which became apparent in early 2004 with terrorist attacks on contractors. Nor could it account for losses from mismanagement, corruption and general inefficiency.

The Iraqi people know their history, their former position in the world, and what it is today. There can be little doubt that the desire of Iraqis is to recover from their history. But, today, in many places throughout the country, they hope for things people of many other nations take for granted: reliable electrical power, clean water, functioning sanitation systems, jobs, incomes, and a future of prosperity and peace.

What resources are available to meet these needs?

The U.S. has met more than half of the funding needs estimated by the World Bank with the investment of almost \$29 billion in U.S. appropriated funds for Iraq. As of today, only seven percent of these funds remain to be committed to programs and projects. Yet, this investment has been eroded by the need to provide security, to protect people and facilities from terrorists. By some estimates, this has taken as much as 26% of the funds, leaving less for construction labor and materials for reconstruction projects.

Other nations of the international community have pledged a total of about \$17 billion to the overall relief and reconstruction effort. However, the delivery of pledged funds and new pledges may be diminishing, as incidents of terror, along with reports of corruption and mismanagement, leave donors with a lack of confidence in reconstruction efforts.

Beyond international aid, about \$30 billion of Iraqi funds, identified as seized, vested, as well as those of the Development Fund for Iraq (DFI) established by the United Nations from Iraqi oil revenues, have also been available for reconstruction. However, SIGIR audits have documented mismanagement and lack of accountability and potential fraud in handling of the funds of the DFI by personnel of the Coalition Provisional Authority. Since sovereignty was returned to the Iraqis in June 2004, audit reports of the Iraqi Board of Supreme Audit, and statements of the Iraqi Commission on Public Integrity have similarly pointed to mismanagement, lack of accountability and potential fraud in handling operating funds of ministries.

New income for Iraq will depend upon expanding oil exports, which Iraqi officials expect will rise to 1.8 million barrels per day by January 2006, just after the scheduled election of a national government. That government will be able to make decisions on foreign investments in their oil sector. For at least the next few years, Iraq will depend upon oil revenues for as much as 60% of its gross domestic product and 95% of its hard currency earnings. Thus, improving the productivity and performance of the oil sector will be the key to jump starting the rest of the Iraqi economy in the years ahead.

While Iraq is sitting on an abundance of crude oil, it is a net importer of refined fuels, due to a lack of refining capacity. This costs the nation more than \$300 million a month. As well, the Iraqi Transitional Government policy is to subsidize fuel prices. According to the IMF, the government paid more than \$7 billion in 2004 to provide the consumer with gasoline and diesel at about a nickel a gallon. At this price, demand is exaggerated, and smugglers have lucrative opportunities to deliver subsidized fuel to neighboring countries where prices are 100 times greater. One third of Iraq's gasoline and diesel fuel is stolen and sold over the border, costing the country about \$2 billion a year.

An additional headwind for the Iraqi economy is the continuing need to service its substantial debts. Despite the reduction by 80% of Iraq's \$39 billion debt by the Paris Club, the remaining 20% remains on the books, along with an estimated \$80 billion still

owed to other nations, mostly Arab states. As well, this debt will only be increased by any loans accepted by Iraq for reconstruction assistance.

Eventually, at the conclusion of the reconstruction program, it will be up to the Iraqis to operate and maintain the infrastructure of new plants and equipment we leave behind, as well as undertake additional reconstruction on their own. A recently completed SIGIR audit on sustainment estimates that the Iraqi government will need between \$650 and \$750 million annually to operate and maintain current projects. On top of this, another 20 to 25% will be needed for security, salaries and fuel. Iraqi funding for support of existing infrastructure is a fraction of what is necessary. It will take time for the Iraqi economy to grow to generate revenues at levels needed to sustain the infrastructure. In this regard, the deck is currently stacked against Iraq.

If the U.S. and the world do not buy the necessary time for Iraq to be able to shoulder their own infrastructure, it will risk undermining, or even reversing, the value of the investments we have made.

The U.S. reconstruction effort is shared by a multiplicity of U.S. military and civilian bureaucracies, resulting in uncertainty about the authority each should exercise. What is needed is strong and coordinated leadership of the many key U.S. agencies engaged in Iraq reconstruction – leadership that delivers results at both the program and execution levels and speaks with one voice.

The Chief of Mission, Ambassador Khalilzad, is vested by National Security Presidential Directive (NSPD-36) as the chief authority over the reconstruction program. His chief management arm for this authority is the Iraq Reconstruction Management Office (IRMO), currently directed by Ambassador Daniel Speckhard. SIGIR is convinced that IRMO can and should aggressively assert leadership over the remaining reconstruction strategy and its final stage of execution.

Coordination of leadership should include coordinated changeover of leadership. This year, there have been major leadership changes in most of the U.S. agencies that manage Iraq reconstruction. These have led to periods of turbulent uncertainty and stagnating progress, as new leaders realign their organizations to their own vision and institutional knowledge is lost. Without strong central leadership, and unsynchronized leadership changes, it has been difficult to achieve a true shared vision. SIGIR hopes that future leadership changes will be better coordinated, allowing more transition time and overlap.

Two persistent reconstruction issues will demand attention of reconstruction management: Iraqi sustainment of the operation and maintenance of completed projects; and, the development of useful cost-to-complete data for projects.

We began our SIGIR audit on Sustainment after we learned that there were few indications that long-term maintenance was being adequately planned. Among our recommendations is the implementation of a sustainment plan for IRRF projects,

including a determination of the capacity of Iraq to maintain them. As well, we recommended the development of supportable cost estimates for sustaining the Iraqi infrastructure in the short and long terms. IRMO has responded by creating an office to lead coordinated efforts to address sustainment. However, IRMO needs authority it does not currently have to accomplish this objective.

SIGIR has long pressed reconstruction management for cost-to-complete data for projects managed by the Project and Contracting Office (PCO), U.S. Army Corps of Engineers, and USAID. This data is essential for effective budgeting during construction project life cycles, especially as projects have been affected by reprogramming, de-obligation and transfers between projects of reconstruction funds. “Budget-to-complete” information is not a substitute. Moreover, the FY2004 Supplemental appropriation that provided the \$18.4 billion IRRF mandated reporting of cost-to-complete data.

A SIGIR audit report earlier this year found that no cost-to-complete data had been provided because IRMO did not enjoin the other reconstruction offices to develop the information. Over the last few months, however, IRMO has pushed for useful data and developed a model that is expected to result in publication of cost-to-complete data. SIGIR will follow up to evaluate and comment on the adequacy of the methodology and data.

As we consider what it will take to bridge the Reconstruction Gap, we are attracted to Ambassador Khalilzad’s efforts to reform global perceptions of Iraq reconstruction as an Iraqi-led initiative, with strong U.S. support. This new emphasis will call for increasing local-level engagement. Evidence of tangible movement in this direction is Ambassador Khalilzad’s strong support of the Provincial Reconstruction Development Committees (PRDC).

Earlier this year, I expressed concern over the lack of a single big-picture view of Iraq reconstruction. To provide some leadership in this regard, we drew on individual databases of financial, project, and contract information, and developed the SIGIR Iraq Reconstruction Information System, or SIRIS. SIGIR audits identified problems caused by the failure of reconstruction management to develop a single-project database.

I am pleased to report that IRMO has moved forward on a unified database that promises to improve the timeliness and accuracy of project reporting and allow for improved program management. The draft requirements for this system include the need to deliver complete and usable data to the Iraqis, provided they can implement a system that can receive the data. SIGIR is continuing to audit the quality of the data in the information management system.

For many months, SIGIR has pressed for more fixed-price, direct contracting to displace cost-plus, design-build projects. During my latest tour in Iraq, I learned that all of the major reconstruction organizations are emphasizing direct contracting, and this appears to be yielding cost-efficient results while stimulating the Iraqi economy.

Finally, bridging the reconstruction gap will require addressing corruption in Iraq. Already new anti-corruption institutions have been established that are without precedent in Iraq, or even in parts of the Middle East. The Coalition Provisional Authority established an anti-corruption program of three interlocking parts: the Commission on Public Integrity (CPI); a system of inspectors general for the Iraq ministries; and, the Board of Supreme Audit (BSA).

The Commission on Public Integrity, led by Judge Rhadi al-Rahdi, is a law-enforcement agency -- Iraq's equivalent of the U.S. Federal Bureau of Investigation. The CPI's 600 employees, including 100 investigators, are working 1,500 cases. More than 500 cases have been forwarded to the Central Criminal Court of Iraq (CCCI). This caseload includes 450 cases of corruption in the Ministry of Defense, some of which have been referred to the CCCI. During my recent tour in Baghdad, I had two productive meetings with Judge Rahdi. He and I discussed a process for exchanging information on cases, and we are working on an agreement to achieve that end.

SIGIR has buttressed the Iraqi Inspectors General system since its inception during CPA over a year ago. The Iraqi IGs have legal authority to "audit, investigate, and review accountability, integrity and oversight of ministries; and to prevent, deter and identify waste, fraud, abuse of authority and illegal acts. Each ministry has an IG office and about 2,000 staff members are employed nationwide. This is a new institution for Iraq, and it will take some time before they have the training, capacity, power and independence to function effectively.

The Board of Supreme Audit is a holdover from the former regime; however it is well respected by the Ministry of Finance, Deputy Prime Minister and other senior Iraqi officials. Despite numerous challenges, and working in a dangerous environment, the BSA is effective and pursuing a regular schedule of audit work across all ministries. The BSA President has expressed interest in using audit work by SIGIR in his ongoing audits. SIGIR audits are available in Arabic to BSA, CPI and the Iraqi IGs, and others through our Web site (www.sigir.mil).

The Iraqi Anti-corruption Program is a critical lynchpin in the long-term success of the establishment of a free and democratic government in Iraq, and is worthy of aggressive U.S. Government. I have urged Ambassador Khalilzad to call a summit with Iraqi anti-corruption officials to demonstrate support for their courageous efforts.

Background on the Office of the Special Inspector General for Iraq Reconstruction

Permit me now to provide you with a brief background on my Office.

The SIGIR is a temporary organization with a very specific mission – to execute oversight of the Iraq Reconstruction and Relief Fund through audits, investigations, and inspections. In simple terms, the Congress created us to report on how the US spent taxpayer dollars in the post-war reconstruction of Iraq.

Congress initially constituted SIGIR as the Coalition Provisional Authority Office of Inspector General (CPA-IG) in November 2003 through Public Law 108-106. That law also provided \$18.4 billion for the Iraq Reconstruction and Relief Fund (the IRRF), which we now oversee. I was appointed in late January 2004, made my first trip to Iraq soon thereafter, and produced our first quarterly report to the Congress in March 2004. SIGIR has produced five more Reports since then.

The CPA ceased operations on June 28, 2004, and the CPA-IG thus was scheduled to expire in December 2004. However, the Congress, recognizing the need for continued oversight, created the Office of the Special Inspector General for Iraq Reconstruction through the 2005 National Defense Authorization Act, which President Bush signed into law on October 29, 2004. I have served as the SIGIR since that date.

I report directly to the Secretaries of State and Defense, and I am charged with auditing and investigating programs and operations funded by the Iraq Relief and Reconstruction Fund. SIGIR is now operating optimally in executing its assigned mission, and we will carry out that mission in the hazardous environment that is Iraq today as long as Congress sees fit.

On-Going SIGIR Activities

During my latest tour in Baghdad, I worked with my staff to advance our audit, investigative, and inspections work. To date, SIGIR has completed and issued 26 audit reports covering a variety of matters affecting the management of Iraq reconstruction. Right now, we have 16 more audits underway, with 14 auditors working them on the ground in Baghdad. Our Quarterly Report to Congress, to be delivered October 30th, will summarize ten new audit reports. These audit reports will provide our concluding reviews of Coalition Provisional Authority activities, our first reporting on CERP, and our next phase of IRRF audits.

I have 10 criminal investigators on the ground in Baghdad, and five in Arlington, who are collectively handling 54 cases as the only significant law enforcement entity on the ground in Iraq looking at corruption issues in the \$18.4 billion IRRF program. These investigators average over 25 years of federal law enforcement experience each and come from the FBI, IRS, and other federal agencies. The investigators are working cases in close coordination with Department of Justice attorneys and several matters are approaching the indictment stage.

We also have initiated a task force called SPITFIRE, which stands for the Special Investigative Task Force for Iraq Reconstruction. It is a partnership with the U.S. Immigration and Customs Enforcement (ICE) of the Department of Homeland Security, the Internal Revenue Service, and the U.S. Department of State's Office of Inspector General.

SPITFIRE's purpose is to use specialized capabilities that enhance our capacity to detect fraud, trace international money laundering transactions, and monitor travel of suspects. Working closely with the Money Laundering and Asset Forfeiture Section of

the Department of Justice, SPITFIRE is succeeding in applying advanced and effective investigative techniques and has referred cases to the Department of Justice for prosecution.

I also have several inspection teams, composed of engineers and auditors that span out across Iraq visiting and reporting on projects, despite the significant personal risk. These teams, which are part of an innovative Special Operations Division that I established within SIGIR, have issued nine reports examining water and electricity projects, with seven more out soon that will report on oil, hospital, railroad station, and police station projects. The electricity, oil and facilities reports and their accompanying photographs will appear in SIGIR's next Quarterly Report. The effect of these rapid-results teams is to provide program managers with near real-time feedback on individual or systemic issues related to actual IRRF projects so they can be addressed immediately. Our close teamwork with reconstruction management has enabled us to identify key weaknesses and raise the issues requiring management action.

The Special Operations Division is also using alternative methods for exerting oversight, including overhead imagery and other ground-based assets to analyze sites. The imagery approach, if successful, will be shared with IRRF management as a potential tool for improving oversight of our work on the ground in Iraq.

SIGIR continues to build upon its accomplishments in Iraq, expanding our capabilities to meet our significant mission. I was pleased that Ambassador Khalilzad has agreed to permit SIGIR to station 10 more personnel in Baghdad. These additional auditors, investigators, and inspectors are essential for me to address all of the important issues that stand before us. As the leading U.S. entity reviewing use of the IRRF in Iraq, SIGIR bears the responsibilities for promoting program success through oversight and "near-real-time" auditing advice, and deterring fraud, waste, and abuse.

I believe that the overwhelming majority of U.S. personnel assigned to the reconstruction program in Iraq are doing their best and working long hours to make it work. My job is to serve as an additional resource that promotes success by advancing efficiency through oversight, to root out corrupt practices, and to report to the Congress and the Secretaries of State and Defense what we find.

Given the fact that the SIGIR is a temporary organization, I want to ensure that the effect of our oversight is "real time," and that we discuss inefficiencies with management as they are found, rather than wait for publication of a final report. Some of our most recent audit reports are examples of this approach. These provided management with a review of certain operating procedures, practices, and accountability measures; upon publication of the reports, most of our recommendations had already been accepted and implemented during the course of the audit. This balanced approach – working with management to make changes now, while retaining our required detachment as an oversight organization – maintains our reportorial integrity, while promoting our collective goal, the highest and best use of U.S. resources in the Iraq reconstruction program.

SIGIR has several initiatives that enhance our operations and add to the effectiveness of our reporting. We created the Iraq Inspectors General Council, which brings together each quarter representatives from all oversight organizations that have jurisdiction over Iraq. This Council, which I chair, discusses and de-conflicts oversight activities in Iraq. We have a parallel organization in Iraq, the Iraq Accountability Working Group, which is led by my Assistant Inspector General for Audit and gathers oversight personnel every other month in Baghdad for program updates. Finally, SIGIR developed a Lessons Learned Initiative that will look at the Iraq reconstruction experience. We will examine human resources, contracting, and program management, respectively, over the course of three day-long forums that gather experts and those with Iraq experience to sift through the evidence and arrive at ground truth on these issues. The first panel on human resources met on September 20, at The Johns Hopkins University. The results of this first lessons learned study will be summarized in the Quarterly Report, and will be published in full in November.

Conclusion

The SIGIR is a specialized, temporary oversight organization with an unusual mission. We seek to provide prompt and effective advice and recommendations to those managing Iraq reconstruction, with the goal of working to promote efficiency, prevent waste, and thus save taxpayer dollars. As the Iraq reconstruction program rapidly moves forward, I believe that SIGIR can continue to play an important role in promoting program success.

My most recent trip to Iraq has convinced me that the U.S. reconstruction leadership, beginning with Ambassador Khalilzad, has recognized the importance of resolving the issues necessary to close the Reconstruction Gap, and that the agencies involved are seeking workable solutions. Much is left to be done; but I am encouraged.

I was pleased that Ambassador Khalilzad welcomed SIGIR's presence within the process, and I agreed with him that SIGIR can and will make important contributions to the success of the next phase of Iraq reconstruction.

I am proud of my staff's willingness to serve in the highly hazardous environment that is Iraq today. They are a dedicated cadre of professionals, and many could be auditing or investigating in much safer and more stable environments. Instead, they have volunteered to serve our country in these challenging times, bringing their expertise to bear on this substantial and significant oversight issue.

SIGIR is carrying out the mission that the Congress has assigned with vigor, speed, and efficiency. In a nutshell, the SIGIR is succeeding and will continue to work as the "Taxpayers' Watchdog" to ensure effective oversight, timely reporting, and to promote the ultimate success of the Iraq reconstruction program.

Thank you for your time and I look forward to answering any questions that the committee may have.