

FOR OFFICIAL USE ONLY
UNTIL RELEASED BY THE SENATE COMMITTEE ON ARMED SERVICES SUBCOMMITTEE
ON READINESS AND MANAGEMENT SUPPORT

**STATEMENT OF STUART W. BOWEN, JR.
SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION**

BEFORE THE

**UNITED STATES SENATE
COMMITTEE ON ARMED SERVICES
SUBCOMMITTEE ON READINESS AND MANAGEMENT SUPPORT**

HEARING ON CONTRACTING ISSUES IN IRAQ

**Tuesday, February 7, 2006
Washington, DC**

Introduction

Mr. Chairman, Ranking Member Akaka, and members of the Subcommittee—thank you for the opportunity to address you today on important matters regarding the role of the United States in the reconstruction of Iraq and the oversight of such efforts provided by my office, the Special Inspector General for Iraq Reconstruction (SIGIR). I hope for a productive exchange of views and ideas in this hearing to illuminate issues and challenges regarding Iraq reconstruction that we are now confronting.

This hearing is particularly timely as I released last week the January 30, 2006 Quarterly Report to Congress and to the Secretaries of State and Defense containing seven new audit reports detailing challenges, issues and concerns in Iraq reconstruction efforts. SIGIR has now completed a total of 70 audit reports and project inspections. Among our 41 audit reports, almost half have dealt with contracting issues. Together, these provide an important perspective on U.S. progress in Iraq.

Throughout 2005, SIGIR provided independent, aggressive oversight to prevent waste, fraud and abuse in the dangerous operating environment in Iraq. My emphasis on real-time auditing – where guidance is provided immediately to management authorities upon the discovery of a need for change – enables rapid improvements that can save taxpayers money.

In our discussion of contracting issues arising from Iraq relief and reconstruction, I will include some information on how we are deriving lessons learned from the experience. I would like to illustrate one important lesson – oversight delayed is oversight denied.

Last week, an individual who had been employed by the CPA to manage reconstruction funds in South-Central Iraq, was convicted of bribery and fraud – the conclusion of a criminal case opened by SIGIR investigators in 2004. This individual is one of four subjects currently identified in connection with criminal activities involving Iraqi money that was intended for the benefit of the Iraqi people.

Court documents released last week contained a number of electronic messages between these individuals as they coordinated their criminal activities. Many of these e-mails were transmitted in January 2004 – a period when their activities, which had already gone on for months, were in full swing,

Coincidentally, in January 2004, January 20th to be precise, I was appointed as the Coalition Provisional Authority Inspector General. This appointment was the first formal, substantive measure to provide oversight of the entire range of Iraq reconstruction programs and operations. Unfortunately, the establishment of an inspector general came months too late to deter these particular criminal activities.

However, while we were not in place to keep these crimes from occurring, the trails of those who committed crimes in Iraq are still warm enough for us to follow. In partnership with the Department of Homeland Security Bureau of Immigration and Customs Enforcement, the Internal Revenue Service Criminal Investigation, and the Department of State Inspector General, we have created an interagency Special Investigative Task Force for Iraq Reconstruction, or SPITFIRE. With our SPITFIRE partners, and with the strong cooperation of the Department of Justice, we will continue to identify, arrest, and prosecute those relative few who dishonored our nation's efforts in the reconstruction of Iraq.

Thus, the important lesson is that oversight works, and it works well when it works hard. But, it works more efficiently the earlier it is put in place. Provisions for formal oversight of Iraq reconstruction should have been established at the very beginning of the endeavor.

While there has been much attention given to our work involving the Iraqi funds that were used by CPA for Iraq reconstruction, our current work chiefly involves the funds appropriated in the Iraq Relief and Reconstruction Fund (IRRF). I believe it is important to address apparent confusion in reports about the funds that were lost from the criminal activities we are investigating: we have found limited evidence of crimes involving appropriated funds provided by the American taxpaying public. Corruption is not a pervasive problem on the U.S. side of the reconstruction program. While we have found and reported inefficiencies and waste in the management of reconstruction contracts, projects, and finances, the problems and lack of controls in spending appropriated funds were far less serious than those that we found, and investigated, in the management of Iraqi funds used in reconstruction.

Even under the difficult conditions of Iraq, we have observed continuous improvement. The multiple organizations engaged in Iraq reconstruction have improved their coordination. The recent reorganization to integrate the Project and Contracting Office (PCO) with the Gulf Regional Division of the Army Corps of Engineers has contributed to these improvements.

Today, to help you to focus on contracting issues in Iraq reconstruction, I will discuss the findings from our audits that looked into contracting issues. SIGIR has conducted 17 audits into contracting matters since we began our work in Iraq in the spring of 2004:

**Award of Sector Design–Build Construction Contracts
(SIGIR-04-005 - July 23, 2004)**

- The DoD Components used competitive procedures to award the design-build construction contracts for rebuilding the Iraqi infrastructure. However, except for the two contracts for the oil sector, the contract awards were limited to sources from designated countries, including the United States, Iraq, coalition partners, and force-contributing nations.
- On awarding these contracts, Army components properly advertised the requirements, developed source selection plans, and had sufficient controls to ensure that the plans were followed.
- As a result, the U.S. government obtained the benefits of competitive contracting, but the PMO faces challenges in ensuring that tasks performed under these contracts fully meet the U.S. government's requirements and are economically and efficiently executed.

Coalition Provisional Authority's Contracting Processes Leading Up To and Including Contract Award

(SIGIR-04-013 – July 27, 2004)

- The audit found that the CPA's Contracting Activity did not consistently provide oversight and technical supervision to the contracting officers awarding contracts on behalf of the CPA and Iraqi ministries.
- Specifically, the Procuring Contracting Officer (PCO) did not ensure that:
 - management information was accurate
 - contract files contained all the required documents
 - a fair and reasonable price was paid for the services received
 - contractors were capable of meeting delivery schedules
 - contractors were paid in accordance with contract requirements
- The CPA-IG recommended the Head of Contracting Activity attempt to recoup unsupported costs associated with a contract reviewed during the audit.

Task Order 0044 of the Logistics Civilian Augmentation Program III Contract

(SIGIR-05-003 – November 23, 2004)

- During the audit, SIGIR identified several problems concerning cost data submitted by KBR to the CPA for work performed under Task Order 0044 (*to provide for logistics and life support for personnel assigned to the CPA mission*). First, KBR did not provide sufficiently detailed cost data to evaluate overall project costs or to determine whether specific costs for services performed were reasonable. As a result, the ACO did not receive sufficient or reliable cost information to effectively manage TO 0044.
- Second, the lack of certified billing or cost and schedule reporting systems hampered effective monitoring of contract costs.
- Third, because the contractor did not provide detailed cost information to support actual expenses incurred, resource managers were unable to accurately forecast funding requirements to complete TO 0044.
- Based on limited audit work, SIGIR also believes that Federal Acquisition Regulations (FAR) Clause 52.216-26, Payments of Allowable Costs Before Definitization, should be enforced because of the lack of definitization for TO 0044.

Compliance with Contract No. W911SO-04-C-0003 Awarded to Aegis Defence Services Limited

(SIGIR-05-005 – April 20, 2005)

- Specifically, Aegis did not provide sufficient documentation to show that all of its employees who were issued weapons were qualified to use those weapons or that its Iraqi employees were properly vetted to ensure that they did not pose an internal security threat.
- Aegis was not fully performing several specific responsibilities required by the contract in the areas of personal security detail qualifications, regional operations centers, and security escorts and movement control.
- Further, SIGIR identified deficiencies in the monitoring of the contract by the Project and Contracting Office (PCO).
- As a result, there is no assurance that Aegis is providing the best possible safety and security for government and reconstruction contractor personnel and facilities as required by the contract.

**Administration of Iraq Relief and Reconstruction Fund Contract Files
(SIGIR-05-007 – April 30, 2005)**

- The PCO did not adequately maintain the 37 contracts and associated contract files SIGIR reviewed, valued at more than \$184 million, to fully support transactions relating to the performance of contract administration processes.
- Further, the PCO could not produce 21 percent, or 10 of the 48 randomly selected contract files for SIGIR's review.
- The PCO generally awarded contracts that contained adequately prepared statements of work, specific contract deliverables, and clearly negotiated contract terms. However, the audit identified significant deficiencies in contract administration processes and controls.
- Consequently, there was no assurance that the contract file data was available, complete, consistent, and reliable or that it could be used to effectively monitor and report the status of contracted project activity for the IRRF.
- The audit identified material management control weaknesses in the administration of contract files. Consequently, there was no assurance that fraud, waste, and abuse did not occur in the management and administration of IRRF contracts.
- Management agreed with the finding and recommendations made in this report. The report contained seven recommendations. Actions have been taken or are underway to correct the reported deficiencies.

**Administration of Contracts Funded by the Development Fund for Iraq
(SIGIR-05-008 – April 30, 2005)**

- PCO did not fully comply with the requirements described in a memorandum from the Iraqi Interim Government Minister of Finance to monitor DFI contract administration.
- PCO and the Joint Area Support Group – Central (JASG-C) comptroller could not accurately identify the current value of obligations, payments, and unpaid obligations for DFI contracts. However, cash payments appeared to be made in a timely manner.
- PCO lacked the necessary controls and adequate documentation to effectively perform their responsibilities to monitor and administer contracts funded by the DFI.
- The audit identified material management control weaknesses in the accounting for DFI contract liabilities and in contract administration.
- Consequently, there was no assurance that fraud, waste, and abuse did not occur in the management and administration of contracts funded by the DFI, that DFI funds were used in a transparent manner, or that DFI funds were used for the purposes mandated by UN Security Council Resolution 1483.
- The report contained six recommendations. Management from PCO and JASG-C agreed with the findings and recommendations made in this report. Actions have been taken or are underway to correct the reported deficiencies.

**Reconciliation of Reporting Differences of the Source of Funds Used on Contracts After June 28, 2004
(SIGIR-05-009 – July 8, 2005)**

- During the course of this audit, SIGIR found that it could not fully address the overall objective because 21 of the 69 contracts identified for review could not be located by government officials.
- SIGIR concluded that the 48 contracts reviewed disclosed no instances of incorrect obligations of DFI funds.

- SIGIR also concluded that the Joint Contracting Command-Iraq (JCC-I) current contract data files were not accurate and not adequately supported.
- Review showed that 48 of the 69 contracts contained data entry errors in documenting the date of the contract award or the source of the funding.
- JCC-I officials stated that the 21 contracts that could not be located may have been destroyed by a rocket that struck the Presidential Palace in January 2005 or that some of these contracts were turned over to Iraqi ministry officials after contract completion and final review by contracting officials. However, the JCC-I had no records to support these conjectures.
- During the audit, the JCC-I corrected the Contract Management Information System reporting errors identified by the audit. SIGIR believes that these actions sufficiently corrected the identified deficiencies.

**Attestation Engagement Report concerning the Award of Non-competitive Contract DACA63-03-D-0005 to Kellogg, Brown and Root Services, Inc.
(SIGIR-05-19 – September 30, 2005)**

- The Director of the Defense Reconstruction Support Office-Iraq (DRSO) asked SIGIR to provide an attestation on a non-competitively awarded contract that Kellogg, Brown and Root obtained before the 2003 Iraq war.
- SIGIR performed the attestation based on agreed-upon procedures of both DRSO and the UN International Advisory and Monitoring Board.
- The purpose of the attestation was to determine whether the non-competitive award of the contract was appropriately justified and whether the goods and services delivered and billed for were those required under the contract.
- SIGIR concluded that the use of the non-competitive contract was appropriately justified and that the goods and services delivered and billed for were those required under the contract.

**Management of Commander's Emergency Response Program for Fiscal Year 2004
(SIGIR-05-014 – October 13, 2005)**

- The overall objective of this audit was to evaluate the adequacy of controls over Commander's Emergency Response Program (CERP) funds.
- Funds available for CERP during the period under review amounted to more than \$727.1 million, of which approximately \$140 million were appropriated funds. SIGIR reviewed CERP transactions made by the U.S. Central Command's Multi-National Force-Iraq (MNF-I).
- SIGIR concluded that, while CERP-appropriated funds were properly used for their intended purposes, overall controls over CERP processes required improvement.

**Acquisition of Armored Vehicles Purchased through Contract W914NS-05-M-1189
(SIGIR-05-018 – October 21, 2005)**

- SIGIR performed this audit after receiving a Hotline complaint
- SIGIR concluded that MNSTC-I purchased seven armored Mercedes-Benz vehicles that did not have the required level of armored protection.
- In addition, MNSTC-I could not locate one of the vehicles after delivery was made.
- Thus SIGIR concluded that MNSTC-I may have paid \$945,000 for armored vehicles that will not meet the purpose intended and may not be available for use.
- SIGIR recommendations included that Commanding General, JCC-I/A, purchase armored vehicles by using standard supply contracts rather than commercial items contracts.

- Management from MNSTC-I and JCC-I/A agreed with the recommendations made in this report. Actions have been taken or are underway to implement the recommendations.

**Award Fee Process for Contractors Involved in Iraq Reconstruction
(SIGIR-05-017 – October 25, 2005)**

- This audit was to determine whether award fees provided to contractors performing IRRF-funded projects are adequately reviewed, properly approved, sufficiently substantiated, and awarded according to established standards.
- In general, cost-plus award-fee contracts include a base award fee (for simply meeting contract requirements) and a merit-based award fee for performance that exceeds contract expectations. For 16 of the 18 contracts reviewed, the base fee component was 3%, the highest base fee allowed by the DoD FAR Supplement.
- However, the 18 contracts did not contain the required criteria with definable metrics. This missing component created the potential for inflated contractor performance evaluations.
- For 9 of the 11 design build contracts, the award fee plans allowed awards of an additional 50-74% of the award fee pool for *average* results.
- For the 7 program management-and-support (PMAS) contracts, the award fee plans permitted awards of an additional 60-70% of the award fee pool for some performance above standard while still allowing several weaknesses in performance to remain.
- SIGIR found that the Award Fee Evaluation Board recommendations and determinations of fees were not documented in sufficient detail to show that the integrity of the award fee determination process had been maintained. Thus, the documentation SIGIR reviewed in contract files was insufficient to substantiate the award fees that were approved.
- JCC-I/A concurred with SIGIR's findings and recommendations. Actions have been taken to comply with this report.
- As a result, award fees are now based on quality performance rather than providing contractors higher fees than deserved.

**Management of Rapid Regional Response Program Grants in South-Central Iraq
(SIGIR-05-015 – October 25, 2005)**

- This audit report was one of a series of reports addressing controls over cash, contract management, and grants management for the Coalition Provisional Authority (CPA) South-Central Region. This audit report discussed the processes used for the authorization, award, execution, and oversight of grants within the CPA South-Central Region.
- SIGIR found that South-Central Region personnel, under the direction of the CPA, did not effectively manage 74 grants awarded through the Rapid Regional Response Program (R3P) amounting to \$20.8 million.
 - South-Central Region personnel could not account for \$20,541,000 in DFI funds provided for R3P grants, and they made payments of \$2,633,500 that exceeded the total value of grants awarded.
 - CPA South-Central Region personnel disbursed \$23,471,500 through 74 grants, although the award value of these grants was only \$20,838,000.
- SIGIR concluded that the South-Central Region failed to manage its R3P grant program.
- Management generally concurred with SIGIR recommendations.

Management of the Contracts, Grant, and Micro-purchases Used To Rehabilitate the Karbala Library
(SIGIR-05-020 – October 26, 2005)

- SIGIR found that, in the management of contracts, a grant, and micropurchase contracts using Rapid Regional Response Program funds, South-Central Region personnel:
 - circumvented guidance by splitting requirements into more than one contract to avoid seeking the required funding-level approval or to avoid required documentation
 - issued contracts for dollar amounts that exceeded requirements
 - did not monitor any contracts, the grant, or micro-purchase contracts; did not make any site visits; did not issue performance reports; did not prepare post-award assessments; did not act on the reports that the contractor was not performing to the standards set in the contracts
 - disbursed funds on contracts, a grant, and micro-purchase contracts for which work was not performed, work was not contracted, equipment and services were not delivered, or the contracted amount was exceeded
 - paid contract amount in full on the day the contracts, grant, and micropurchase contracts were signed and did not require that progress payments be tied to project performance
 - did not maintain files with accurate or required documentation
- South-Central Region personnel, under the direction of the CPA, did not comply with applicable guidance and did not properly manage R3P funds provided through 5 contracts, 1 grant, and 33 micro-purchase contracts used to rehabilitate the Library. Specifically, South-Central Region needlessly disbursed more than \$1.8 million for contracts, a grant, and micro-purchase contracts for which work was not performed, and the contracted amount was exceeded.
- Further, more than \$2.3 million in R3P funds was disbursed despite the fact that the total value of the contracts, grant, and micro-purchase contracts awarded for the Library was about \$2.1 million.
- The Director of IRMO, the Commanding General, JCC-I/A, and the Commander, JASG-C Baghdad concurred with the finding and recommendations.

Management of the Contracts and Grants Used To Construct and Operate the Babylon Police Academy
(SIGIR-05-016 – October 26, 2005)

- SIGIR found that, in the management of contracts and grants using R3P funds, South-Central Region personnel:
 - entered into an unauthorized land grant and violated conflict-of-interest rules
 - circumvented guidance by splitting requirements into more than one contract to avoid having to seek the appropriate funding-level approval and needlessly expended funds because work was not consolidated into a single contract
 - did not make site visits, did not issue final performance reports, and did not properly prepare certificates of completion forms
 - disbursed funds before contracts and grants were signed
 - did not establish the required separation of duties as a control over the disbursement of funds
 - did not maintain files that contained accurate or required documentation
- As a result, South-Central Region personnel, under the direction of CPA, did not comply with applicable guidance and did not properly manage approximately \$7.3 million of R3P funds. Specifically, South-Central Region needlessly expended almost \$1.3 million in contract funds for

duplicate construction projects; unnecessary or overpriced equipment; and requirements not identified in contract documents.

- Further, the South-Central Region could not account for more than \$2 million of disbursed grant funds.
- Management concurred with the recommendations made in this report. Actions have been taken or are underway to implement the recommendations.

Management of Rapid Regional Response Program Contracts in South-Central Iraq (SIGIR-05-023 – January 23, 2006)

- SIGIR found that South-Central Region personnel, under the direction of CPA, did not effectively manage 907 contracts and 1,212 micro-purchase contracts that were awarded through the RRRP, amounting to \$88.1 million. As a result:
 - 4 projects, using 20 contracts (2.2%) and several contract modifications, totaling approximately \$9.1 million, apparently split requirements to keep the contract awards below the \$500,000 approval threshold so as to circumvent the required reviews and reporting.
 - 158 contracts (17.4%), totaling approximately \$16.3 million, were either not competitively awarded or lacked documentation that showed a competitive process had taken place, and 26 contract files (3.0%), totaling approximately \$2.6 million, did not contain a signed contract.
 - 11 contracts (1.2%), totaling more than \$5.6 million, were issued without proper authorization, and 38 contracts (4.2%), totaling approximately \$7.0 million, were awarded after the transfer of responsibility for the DFI to the Iraqi government on June 28, 2004.
 - 91 projects (10.7%), totaling approximately \$11.6 million, were paid in full at the time of contract signing, and the completion of the project work was not verified; 11 contracts (1.2%) were overpaid by \$571,823; approximately \$515,000 was disbursed for CPA salaries and operations in violation of Program Review Board Guidance 06.2 (amended); approximately \$47,000-\$87,000 in cash was lost but not reported to the CPA Comptroller; and approximately \$23 million was transferred to unauthorized personnel, but documentation showed only \$6.3 million disbursed to contractors resulting in the loss of oversight of \$16.7 million.
 - 286 contract files (31.5%), totaling approximately \$31 million, did not contain certificates of completion, yet \$24 million had been disbursed for the projects. Other contract files were missing documentation for approximately \$12.6 million in disbursements and consequently, it could not be determined whether contractors were properly paid for work actually performed.
 - A property record book to document the property purchased with RRRP funds was not maintained; contract files for 160 vehicles, totaling approximately \$3.3 million, did not document the receipt of the vehicles, and there was limited documentation in the contract files to identify whether the beneficiary actually received the vehicles; ammunition and weapons were purchased, but detailed records of deliveries and distribution were not maintained; and not all of the weapons could be located.
 - 346 micro-purchase contracts (28.5%) exceeded the micro-purchase dollar limitation of \$5,000 yet did not maintain the required documentation in the files for awards greater than \$5,000; 387 micropurchase contract files (31.9%) did not contain disbursement documentation; 786 files (64.9%) did not contain a vendor invoice; and 838 files (69.1%) did not have a completion document.

- SIGIR also identified material internal control weaknesses. U.S. government agents and coalition partners did not comply with applicable guidance and did not properly control and account for Iraqi cash assets. Further, SIGIR found indications of potential fraud and referred these matters to the SIGIR Assistant Inspector General for Investigations for action. Related investigations are continuing.
- Based on the documentation examined, SIGIR concluded that CPA South-Central Region failed to adequately manage its RRRP contracts and micro-purchases
- Both the Commanding General, JCC-I/A and the Commander, JASG-C concurred with the findings and recommendations. Both Commands have actions underway to implement the recommendations, and the comments to all recommendations are fully responsive.

Management of the Commander's Emergency Response Program (CERP) for Fiscal Year 2005 (SIGIR-05-025 – January 23, 2006)

- SIGIR found that MNF-I had made considerable progress to improve the management of CERP. This included the improved alignment of projects with MNF-I strategic objectives, centralized tracking of project status and management of project records, and coordination of CERP with other U.S. reconstruction programs.
- SIGIR found, however, that the project data MNF-I used to track the progress of projects and report the status of projects to higher headquarter units contained several errors, and MNF-I units still did not fully comply with requirements for project records. In addition, SIGIR found that MNF-I lacked a consistent process to coordinate CERP projects with DoS and USAID when CERP was used in conjunction with other reconstruction programs in Iraq, and that it did not coordinate with DoS for the sustainment of large CERP construction projects.
- During the course of this audit, SIGIR notified MNF-I of its concerns about errors in the project-tracking tool. As a result, MNF-I initiated its own review of its FY 2005 project data. In addition, MNF-I and the U.S. Embassy-Iraq published a Joint Mission Statement on December 6, 2005, which stated that all political, military, and economic tools available to U.S. agencies in Iraq will be integrated in FY 2006 to maximize the effectiveness of U.S. efforts to rebuild Iraq.
- On behalf of MNF-I, the Multi-National Corps-Iraq (MNC-I) concurred or partially concurred with four of five recommendations of the report. SIGIR generally agreed with the comments provided by MNC-I and, in some cases, changed its report accordingly. USAID also provided technical comments for this report. SIGIR agreed with the comments and changed the audit report accordingly. The comments received are fully responsive.

Prompt Payment Act: Analysis of Expenditures Made from the Iraq Relief and Reconstruction Fund

(SIGIR 06-002 February 3, 2006)

- In FY2005, approximately \$1.4 million in interest penalty payments were made by the Army against Iraq Relief and Reconstruction Fund disbursements of about \$5.275 billion made by Department of Defense organizations because of late payments of contractor invoices.
- This amount of interest exceeded an Army management goal that there be no more than \$85 in interest penalty payments for every million dollars disbursed; the \$1.4 million in interest penalties paid amounted to about \$259 in interest penalties per million disbursed and exceeded the Army goal by 304 percent.
- As a result, interest penalties paid to contractors from the Iraq Relief and Reconstruction Fund appropriation reduced, dollar-for-dollar, the availability of funds appropriated for the reconstruction of Iraq and for the benefit of the Iraqi people.

- The Office of the Assistant Secretary of the Army (Financial Management and Comptroller) concurred with the finding and recommendation and the comments to the recommendation are fully responsive.

All SIGIR audit reports are available to the public on our Web site at www.sigir.mil.

In addition to providing these typical products of inspector general oversight, SIGIR has also undertaken development of a retrospective analysis of the U.S. reconstruction experience in Iraq. This lessons-learned initiative is unfolding in three parts: human capital management, contracting, and program management.

Our lessons-learned process is rigorous. In addition to the significant data we have collected in our normal oversight activities, we have gathered information from a broad range of sources, especially from those who had boots-on-the-ground Iraq reconstruction experience. As well, we have been successful in attracting the participation of experts, in and out of government, to help us to understand clearly, what our nation must learn from the Iraq reconstruction experience.

As this hearing is intended to encompass contracting for Iraq reconstruction, I offer a preview of our Lessons Learned project on Contracting.

SIGIR began research on Iraq Reconstruction contracting in early autumn 2005. In December 2005, we completed a draft Contracting Lessons Learned Report, which we presented to two forums made up of experts involved with Iraq Reconstruction contracting. The first forum was for government officials, academics, and officials of non-profit organizations and think tanks. The second forum was for private sector personnel who held (or hold) Iraq reconstruction contracts from USAID and/or DOD. We are currently in the process of incorporating the information gained from these two events, further research, and interviews into the draft report. The revised paper will then be sent to Forum members and other appropriate persons for vetting, before final publication.

Based on our research thus far, SIGIR has made the following key observations concerning Iraq Reconstruction contracting:

The need for cooperation and collaboration is the overarching requirement for successful post-conflict reconstruction contracting. The job in Iraq proved just too big for one agency or contractor. US agencies and departments have various capacities, flexibilities, and differing areas of expertise in terms of contracting and program management. In Iraq, efforts seemed to be most successful when different agencies understood and leveraged each other's mandates, needs, skills, and strengths. Unfortunately, SIGIR research found many situations in which agencies' lack of cooperation contributed to contracting inefficiencies.

Other Observations:

- **Inclusion of Contracting Staff from the Beginning of Any Reconstruction Effort.** SIGIR research found that there was general agreement among agencies concerned with Iraq Reconstruction that contracting plays a central role in mission execution and cannot be an afterthought in the planning process. Whether for stabilization or reconstruction, contracting officials can provide an accurate and holistic picture of the resources needed to efficiently contract for a given mission. This understanding extends to the number of personnel required, their skills and functional areas, and the systems and procedures required for them to operate efficiently.

- **Use of Flexible Contracting Mechanisms.** There is mixed opinion in the government contracting community about whether a “wartime FAR” or other additional contracting regulations are required for post-conflict reconstruction efforts. Our information to date indicates that there needs to be a broader understanding of the flexibilities that currently exist in the FAR and its supplements, as well as the acceptable use of waivers and other provisions that apply when speed and flexibility are critical. SIGIR research indicates that not all contracting personnel in Iraq were properly informed about FAR flexibilities and thus were sometimes hesitant to use them, fearing that they might be subject to penalties for incorrect or improper use of these options. Methods are needed that would ensure personnel have the necessary knowledge and also the confidence to use such flexible mechanisms when necessary.
- **The Need for Better Requirements.** In order to efficiently procure an item or a service, contracting personnel must be provided with an adequate description of customers’ needs. The inability to properly define and prepare these “requirements statements” for projects appears to be a significant and continuing shortcoming of the Iraq Reconstruction process. To remedy this, customers and contracting personnel must work closely together on a continuing basis. There also needs to be sufficient personnel on the customer side -- both in the field and in the US – capable of laying out requirements with appropriate detail and accuracy. Moreover, in Iraq, this ability must be transferred to local personnel through capacity building, in order to strengthen long-term contracting capabilities.
- **Use of Special Contracting Programs.** During the reconstruction effort in Iraq, various programs containing flexible funding and contracting mechanisms were used in order to enable quick execution of small-scale projects. Some of these, such as USAID’s Office of Transitional Initiatives (OTI), predated the US intervention in Iraq, while others apparently evolved out of necessity during the conflict, such as the Commanders’ Emergency Response Program (CERP) and the Commanders’ Humanitarian Relief and Reconstruction Program (CHRRP). Other such programs included CPA’s “Accelerated Iraq Reconstruction Program (AIRP)” and the Project and Contracting Office’s (PCO) Rapid Contracting Initiative for the electricity sector.

 - The focus of these programs was to meet immediate needs – especially employment generation that would help ameliorate security conditions – and not necessarily the long-term reconstruction of the country. Yet, these smaller programs appear to be vital to creating an environment conducive to and able to absorb larger, more sustainable reconstruction efforts.
 - Given the generally positive performance of these programs, it would be important in future reconstruction efforts to make available designated pools of flexible funds for such initiatives, and to create standardized, but unrestrictive, mechanisms for contracting and managing these funds. It should be noted, however, that these programs can present accountability challenges due to their speed and flexibility.
- **Sustainment of Advances and Innovations.** Lessons have been learned throughout the experience of Iraq Reconstruction contracting, resulting in improvements to contracting and related processes. Examples include: the development of civilian-military partnerships, creation of centralized contracting coordination, flexible contracting mechanisms, and personnel who arrive in country better prepared to carry out their required tasks. This gain in understanding and capability needs to be institutionalized within the concerned US government agencies for application in future post-conflict reconstruction events.

Overall Impact Of The Security Situation On Contracting This is an area where SIGIR continues to carry out research and looks forward to providing more information as our findings develop.

Transition

2006 is a year of transition for the U.S. reconstruction program in Iraq. The successful December 2005 elections launched Iraq into a new phase of its history. The first government elected under Iraq's new constitution is now forming and will soon assume responsibility for managing Iraq's economy and infrastructure.

By the end of this fiscal year, the U. S. expects to have fully obligated the Iraq Relief and Reconstruction Fund (IRRF). IRRF dollars represent only a portion of the amount estimated by the World Bank and United Nations (UN) to be necessary to restore Iraq's infrastructure. The IRRF has provided a substantial down payment on what will be a lengthy restoration process. The progress made thus far with U.S. reconstruction funds has supplied the new Iraqi government with a significant start toward establishing an effective infrastructure and eventual prosperity.

As more and more IRRF-funded projects are completed, the U.S. agencies and elements that currently manage and implement the overall U.S. reconstruction effort, including the Iraq Reconstruction Management Office (IRMO), U.S. Agency for International Development (USAID), and the U.S. Army Corps of Engineers Gulf Region Division Project and Contracting Office (GRD-PCO), will implement transition strategies to ensure that completed projects and related assets are turned over to the appropriate Iraqi officials who have the training and budgetary resources necessary to sustain them.

As the transition process gains momentum, the U.S. reconstruction presence in Iraq should begin to shift toward foreign assistance programs managed by the Department of State (DoS) and the U.S. Agency for International Development (USAID).

Regarding the reconstruction transition, SIGIR has several concerns:

- Do all of the U.S. reconstruction implementing agencies in Iraq have strategic plans in place for transitioning their respective parts of the reconstruction program?
- Are there sufficient resources to support capacity development for national and local government officials, operations and maintenance, infrastructure security?
- Have Iraqi officials sufficiently budgeted and planned for the essential maintenance of the new, U.S.-provided infrastructure?
- Is the United States prepared to sustain the reconstruction presence required to complete planned projects that may take another three or four years to complete?

There are significant signs that transition planning is being implemented – the Iraq Reconstruction and Management Office, Department of State and Department of Defense are reviewing critical issues of funding and transition. The importance of this issue compels SIGIR to announce a new audit to review all reconstruction transition planning.

Reconstruction Gap

SIGIR introduced the concept of the Reconstruction Gap with our October 30 Report to Congress. We define the Reconstruction Gap as the difference between what was originally planned for reconstruction in the various sectors and what will actually be delivered.

To be clear, this is not an alarm bell, but merely an observation of a current reality: Changing conditions in Iraq, including deteriorating security conditions and evolving political and economic priorities, required IRRF reprogramming that altered sector funding levels and projected outcomes.

During the last quarter, we conducted an audit to examine the Reconstruction Gap further. We found that the U.S. government will not complete the number of projects anticipated by the IRRF program allocations in the November 2003 legislation. Our audit found these shortfalls:

- Of the 136 projects originally planned in the Water sector, only 49 (36%) will be completed. Most of the projects planned in sewerage, irrigation and drainage, major irrigation, and dams have been cancelled .
- Of the 425 projects originally planned by CPA in the Electricity sector, only 300 (70.5%) will be completed. Of the 3,400 additional megawatts planned for the Generation sub-sector, 2,200 megawatts will be delivered.

These shortfalls are substantially attributable to the autumn 2004 IRRF reprogramming, which increased the funding available for security by reducing the allocations to the Water sector from \$4.3 billion to \$2.1 billion (down 51.2%). The Electricity sector dropped from \$5.560 billion to \$4.309 billion (down 22.5%). Allocations to certain other sectors in addition to security increased: the Private Sector Development sector grew from a very low by 420%, and the Justice, Public Safety, Infrastructure, and Civil Society sector rose by 70%.

A number of factors combined to make these program changes necessary, the most significant being the rise of the insurgency. A new strategy that was more responsive to the new security and political situation in Iraq resulted in the reallocation of a total of \$5.6 billion in IRRF funding since August 2004. Additionally, administrative costs of the U.S. agencies implementing IRRF programs caused another \$425 million in programcuts. Another \$350 million is now budgeted for new sustainment activities that were not included in original planning. Finally, the following factors have also contributed to the reconstruction gap:

- inadequate or non-existent cost estimates for many projects in the original November 2003 plan
- increased costs of materials, particularly in the Oil and Gas sector, aggravated by smuggling of subsidized construction materials across Iraq's borders
- high costs of contractor security
- high costs of project delays caused by intimidation and violence
- evolving reconstruction priorities to fit the Multi-National Force-Iraq campaign plan and political requirements
- lack of oversight of reconstruction projects as they developed

I believe that more resources must be allocated to sustainability – the ability of a program to deliver its intended benefits for an extended period of time after major financial, managerial, and technical assistance from an external donor is terminated.

But the story of the Reconstruction Gap is fundamentally about security needs driven by a lethal and persistent insurgency. In addition to the reallocation by DoS of \$1.8 billion to training and equipping Iraqi security forces, the costs for the security of contractors have risen on average to more than 25%.

While this security spending reduces the funds available for actual reconstruction, it is vital. This is demonstrated most clearly by the number of contractors killed, kidnapped or wounded. Intimidation of

workers continues to delay projects, and the insecure environment has driven away critically needed foreign technicians in the essential service sectors.

It is difficult to overstate the impact of violence on the reconstruction program. Often, those commenting on Iraq reconstruction begin by stating that electrical capacity is lower than pre-war levels. They are correct. However, not many realize that electrical capacity grew above pre-war levels in mid-2004 and peaked in July 2005. Since then, however, the insurgents have targeted the electrical infrastructure, sabotaging the towers that carry high-voltage lines to Baghdad from generating facilities in the south. As well, increasing demand for electricity, provided to consumers at no cost, the influx of new appliances and new customers, and the creation of new industries, businesses, factories and jobs also contribute to nationwide shortages.

Sustainability

A SIGIR audit report published October 24, 2005 noted: “There is a growing recognition that the Iraqi government is not yet prepared to take over the near- or long-term management and funding of infrastructure developed through the IRRF projects.” Key recommendations from the October Quarterly Report—including the creation of a Sustainment Coordinator—have been implemented, but the coordinative function should continue to be a high priority for reconstruction managers in Iraq.

SIGIR audits conducted this quarter made these key sustainability recommendations:

- Create a single database of IRRF-related assets and provide it to the Iraqi government to support planning and budgeting.
- Coordinate plans and funding for the sustainment of Commander’s Emergency Response Program (CERP) construction projects with DoS, IRMO, GRD-PCO, and USAID.

Through our project inspections, which are conducted by teams of SIGIR auditors and engineers, we also gain insight into the sustainability of reconstruction projects.

Cost-to-Complete

The cost-to-complete a project is defined as the total estimated cost of the project, less the actual cost of work performed to date. Nearly a year ago, SIGIR reported that the U.S. reconstruction program did not have reliable cost-to-complete estimates for its projects. The failure to compile and report cost-to-complete information, as required by Public Law 108-106, has made it difficult for implementing agencies to exercise effective fiscal management of IRRF dollars. Without current and accurate cost-to-complete data, management cannot determine whether sufficient funds will be available to complete ongoing work, nor can it project the availability of funds for any new programs or projects. This has also deprived SIGIR of the financial visibility I need to execute my oversight responsibility.

For the past year, SIGIR auditors have continually pressed for accurate cost-to-complete data. DoS confronted the issue last spring: in March 2005, a DoS team went to Baghdad to press for cost-to-complete data from agencies implementing the IRRF. This effort has produced limited success.

Anticorruption Efforts

Success in the reconstruction could be eroded in the long term unless Iraq is successful in developing and implementing substantial anticorruption measures. SIGIR is committed to intensifying U.S. efforts to promote an effective anticorruption system within the Iraqi government and commends the U.S. Mission’s efforts thus far to support anticorruption institutions in Iraq. In the October 2005 Quarterly

Report, we urged the Ambassador to hold an anticorruption summit, which he did in November 2005. The summit resulted in a proposal for a joint U.S.-Iraqi Anticorruption Working Group and initial agreement on the need for more training for officials from the Board of Supreme Audit, the Commission on Public Integrity, and the Inspectors General of the Iraqi ministries. The Embassy Anticorruption Working Group previously identified several major priorities, including:

- promoting market reforms and reducing subsidies
- helping to reinforce the weak law enforcement structure
- creating a public education campaign on the corruption issue

SIGIR continues to support the Iraqi Inspectors General system since its inception in 2004. The Iraqi IGs are charged with auditing, investigating, and reviewing the accountability and integrity of the ministries, and with preventing, deterring and detecting waste, fraud and abuse. Although this is a new system in Iraq, and in the region, and will take time to function effectively, the continued development and progress is encouraging.

In addition, the Board of Supreme Audit (BSA), though a holdover from the prior regime, is well respected by senior Iraqi officials and provides effective audit work across all ministries. Despite the hazardous environment in which we all find ourselves working, the BSA has expressed interest in using SIGIR's audit work in its own efforts.

As the anticorruption efforts continue, SIGIR will audit to evaluate progress.

The Way Ahead

As I have noted, 2006 is a year of transition for Iraq reconstruction, and of course, the Congress will face key decisions. As of February 1, the State Department reports that 84 percent of the \$18.4 billion Iraq Relief and Reconstruction Fund is obligated, under contract. What remains is less than \$3 billion, which we estimate will not permit the completion of all projects that were envisioned when the requirement for \$18.4 billion was being determined in late 2003.

While SIGIR has identified a Reconstruction Gap based on these initial requirements, and noted that water and electrical projects will not be completed, I reiterate that this is an observation – not an alarm bell.

Our conclusions on this matter do not constitute an evaluation of the original list of projects. We are not saying that all of these problems must be finished to complete successfully the U.S. investment in the reconstruction of Iraq. In our view, rather than to focus the remaining resources on finishing up this list of projects, our investment in ensuring the sustainment of projects that are or will be completed, and efforts toward building the capacity of the Iraqis to take over the repair of their infrastructure will bring a much higher return.

Also, among the improvements we have observed in the past year is the development of an integrated information management system to provide a more accurate picture for program management.

I am pleased to say that the cooperation that this inspector general is receiving from those engaged in Iraq reconstruction is refreshing. When I return to Iraq later this week, I will be in regular contact with senior reconstruction management, including IRMO director Ambassador Dan Speckhard, Army Corps of Engineers Gulf Regional Division commander Brigadier General Bill McCoy, and Major General Darryl A. Scott, who recently relieved Major General John Urias, as Commander, Joint Contracting Office –

Iraq. As well, I regularly meet with Ambassador Zalmay Khalilzad and the Multi-National Force – Iraq Commanding General, George W. Casey, Jr. Our relations are positive and productive and they are providing our 45 SIGIR auditors, inspectors, engineers and investigators in Iraq the access they need to provide this important oversight.

And in Washington, I met with Secretary of State Condoleezza Rice and Deputy Secretary of Defense Gordon England, and it is clear to me that they support our oversight.

Conclusion

We at SIGIR are vigorously carrying out the duties and responsibilities assigned by Congress in a very hazardous environment. I am proud of my staff's commitment and willingness to serve in a dangerous land far from their families. We will continue to ensure effective oversight and timely reporting, and to promote the success of the Iraq reconstruction plan.

I am gratified that Congress has recognized the impact of my office through the extension of our tenure. On November 10, the Congress passed Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2006 containing an amendment to extend the duration of SIGIR oversight by modifying the SIGIR termination clause to base it upon the level of IRRF expenditures, instead of obligations. I will continue to serve Congress and the Secretaries of State and Defense by providing rigorous oversight to prevent waste, fraud and abuse in Iraq.

I appreciate this opportunity to participate in this important hearing, and I look forward to answering any questions that the committee may have.