THE DEVELOPMENT FUND FOR IRAQ: U.S. MANAGEMENT OF IRAQ OIL PROCEEDS AND COMPLIANCE WITH U.N. SECURITY COUNCIL RESOLUTION 1483

HEARING

BEFORE THE

SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS, AND INTERNATIONAL RELATIONS

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

JUNE 21, 2005

Serial No. 109–72

Printed for the use of the Committee on Government Reform

Available via the World Wide Web: http://www.gpoaccess.gov/congress/index.html
http://www.house.gov/reform

U.S. GOVERNMENT PRINTING OFFICE

23–689 PDF WASHINGTON : 2005

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THE DEVELOPMENT FUND FOR IRAQ: U.S. MANAGEMENT OF IRAQ OIL PROCEEDS AND COMPLIANCE WITH U.N. SECURITY COUNCIL RESOLUTION 1483

TUESDAY, JUNE 21, 2005

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS, AND INTERNATIONAL RELATIONS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2157, Rayburn House Office Building, Hon. Christopher Shays (chairman of the subcommittee) presiding.

Present: Representatives Shays, Van Hollen, Sanders, Maloney, Higgins, Waxman, Kucinich, Marchant, Burton, Turner, Duncan, Ruppersberger, and Lynch.

Staff present: Lawrence Halloran, staff director and counsel; J. Vincent Chase, chief investigator; R. Nicholas Palarino, Ph.D, senior policy advisor; Thomas Costa, professional staff member; Robert A. Briggs, clerk; Sam Raymond, intern; Phil Barnett, minority staff director/chief counsel; Kristin Amerling, minority general counsel; Karen Lightfoot, minority communications director/senior policy advisor; Jeff Baran and Michael McCarthy, minority counsels; David Rapallo, minority chief investigative counsel; Andrew Su, minority professional staff member; Earley Green, minority chief clerk; and Jean Gosa, minority assistant clerk.

Mr. SHAYS. A quorum being present, the Subcommittee on National Security, Emerging Threats, and International Relations hearing entitled, "The Development Fund for Iraq: U.S. Management of Iraq Oil Proceeds and Compliance with U.N. Security Council Resolution 1483," is called to order.

As successor to the United Nations Oil-for-Food Program, the Development Fund for Iraq [DFI], inherited more than money. The DFI was also bequeathed the mission to maintain essential food and fuel flows and to launch a nationwide reconstruction program, despite a looted public infrastructure, a dysfunctional civil government, and a savage insurgency. Nevertheless, the International Coalition willingly took on the U.N. Security Council mandate to administer the fund "in a transparent manner for the economic reconstruction and repair of Iraq's infrastructure and for other purposes benefiting the people of Iraq."

This hearing builds on the Government Reform Committee's assessment of Iraq reconstruction contracting and financial manage-

ment and asks specifically how one member of the coalition, the United States, met that fiduciary commitment to transparency. Last year the full committee held four hearings on contract management challenges in Iraq. They examined in detail the complex, multi-step processes and layered safeguards applied to cost plus fee contracts.

Those audited procedures and fiscal protections are still at work finalizing actual payments on the sole source reconstruction Iraq oil, task orders, and other contracts. Yet, today, some may feel the need to retrace those steps or prematurely label pending contract amounts as overcharges in what I think is a tired and transparent effort to ensnare the administration, the Vice President, and his former employer, Halliburton, in a breathless web of circumstance and supposition.

In truth, there was no need to exaggerate or jump to conclusions about problems in Iraq. Security conditions, cultural idiosyncracies, and an all-cash economy there pose enormous challenges to the conduct of public business as we know it here.

The Inspector General and the U.N. International Advisory and Monetary Board [IAMB], have raised legitimate questions about operations of the DFI. Those issues merit our serious attention today, but serious scrutiny demands precision. Words like "overcharge" and "fraud" have exact legal meanings in this context. They should not be used injudiciously or for sensational effect. Facts and opinions are not interchangeable. We may well disagree on their ultimate meaning and impact, but our purpose here today is first to find facts.

It is a fact that more than $8 billion in cash was distributed to Iraqi ministries between April 2003, and June 2004. It is a fact that the Iraqis decided how to spend that money. It is fact that people were paid, projects were built, and things we purchased with that cash. It is a fact the Inspector General faulted the Coalition Provisional Authority [CPA], for a failure to implement consistent oversight and adequate controls over those expenditures.

But, as the Inspector General will testify, it is a misunderstanding to conclude the absence of accounting controls, alone, means some or all the funds at issue were misused or stolen.

It is also a fact the Department of Defense [DOD], provided only heavily redacted copies of Defense Contract Audit Agency [DCAA] reports on DFI spending to the U.N. Oversight Board, the IAMB. The redactions violated the commitment to transparency and regretfully, very regretfully, make it appear DOD has something to hide. This undermines our international standing and even more seriously harms our efforts in Iraq. This is a self-inflicted wound, a needless failure to meet transparency obligations.

U.N. Security Council Resolution 1483 committed the United States to an extraordinary level of disclosure for DFI transactions, but it appears that commitment had little impact on the Pentagon's practice of deferring completely to the contractors' absurdly expansive view of what constitutes "proprietary information" that must be shielded from view.

After repeated requests to DOD and lengthy delays getting a response, the IAMB was justifiably dissatisfied with redacted DCAA audit reports that hid almost every meaningful number or ref-

erence to question an unsupported contract cost, the very matters of most concern to them and, frankly, to us.

The plundering of the Oil-for-Food Program was hidden by a suffocating lack of transparency at the U.N. The world promised the development fund for Iraq would be different, that Iraqi money would be spent solely for the benefit of Iraqi people. We convene this morning on their behalf. It is their money we are talking about. They deserve a fair accounting of our stewardship.

After eight trips to Iraq, it is clear to me we have made progress and we have made mistakes. Our burden as well-intentioned liberators is this: the progress belongs to the people of Iraq. The mistakes are ours to remedy.

Our management of the DFI has much to teach us about both. Our witnesses will help provide essential substance and needed context to our discussion of the development fund for Iraq. We appreciate their time and expertise, and we look forward to their testimony.

I might say parenthetically it boggles my mind that some who are appearing before us do not have written testimony, after the time that we gave you to prepare for that testimony. That, I think, harms your cause, makes us look bad, and hurts this process.

At this time the Chair would recognize Mr. Kucinich, the ranking member of this subcommittee.

[The prepared statement of Hon. Christopher Shays follows:]

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Statement of Rep. Christopher Shays
June 21, 2005

As successor to the United Nation's Oil-for-Food Program, the Development Fund for Iraq (DFI) inherited more than money. The DFI was also bequeathed the mission to maintain essential food and fuel flows, and to launch a nationwide reconstruction program, despite a looted public infrastructure, a dysfunctional civil government and a savage insurgency. Nevertheless, the international Coalition willingly took on the U.N. Security Council mandate to administer the fund "in a transparent manner for the economic reconstruction and repair of Iraq's infrastructure … and for other purposes benefiting the people of Iraq."

This hearing builds on the Government Reform Committee's assessment of Iraq reconstruction contracting and financial management, and asks specifically how one member of the Coalition – the United States – met that fiduciary commitment to transparency.

Last year the full committee held four hearings on contract management challenges in Iraq. They examined in detail the complex, multi-step processes and layered safeguards applied to cost-plus-fee contracts. Those audit procedures and fiscal protections are still at work finalizing actual payments on the sole-source Reconstruct Iraqi Oil (RIO) task orders and other contracts. Yet today some may feel the need to retrace those steps, or prematurely label pending contract amounts as "overcharges," in a tired and transparent effort to ensnare the Administration, the Vice President, and his former employer Halliburton in a breathless web of circumstance and supposition.

In truth, there is no need to exaggerate or jump to conclusions about problems in Iraq. Security conditions, cultural idiosyncrasies and an all-cash economy there pose enormous challenges to the conduct of public business as we know it here. The Inspector General and the U.N. International Advisory and Monitoring Board (IAMB) have raised legitimate questions about operation of the DFI. Those issues merit our serious attention today.

But serious scrutiny demands precision. Words like "overcharge" and "fraud" have exact legal meanings in this context. They should not be used injudiciously or for sensational effect. Facts and opinions are not interchangeable. We may well disagree on their ultimate meaning and impact, but our purpose here today is to first find facts.

It is a fact that more than eight billion dollars in cash was distributed to Iraqi ministries between April 2003 and June 2004. It is a fact that the Iraqis decided how to spend that money. It is fact that people were paid, projects were built and things were purchased with that cash. It is a fact the Inspector General faulted the Coalition Provisional Authority (CPA) for a failure to implement consistent oversight and adequate controls over those expenditures. But, as the Inspector General will testify, it is a "misunderstanding" to conclude the absence of accounting controls alone means some or all the funds at issue were misused or stolen

It is also a fact the Department of Defense (DOD) provided only heavily redacted copies of Defense Contract Audit Agency (DCAA) reports on DFI spending to the UN oversight body, the IAMB. The redactions violated the commitment to transparency and regretfully make it appear DOD has something to hide. This undermines our international standing and harms our efforts in Iraq.

That was a self-inflicted wound, a needless failure to meet transparency obligations. UN Security Council Resolution 1483 committed the United States to an extraordinary level of disclosure for DFI transactions. But it appears that commitment had little impact on the Pentagon's practice of deferring completely to the contractor's absurdly expansive view of what constitutes "proprietary information" that must be shielded from view.

After repeated requests to DOD, and lengthy delays getting a response, the IAMB was justifiably dissatisfied with redacted DCAA audit reports that hid almost every meaningful number or reference to questioned and unsupported contract costs – the very matters of most concern to them. The plundering of the Oil-for-Food Program was hidden by a suffocating lack of transparency at the UN. The world promised the Development Fund for Iraq would be different, that Iraqi money would be spent solely for the benefit of the Iraqi people.

We convene this morning on their behalf. It's their money we're talking about. They deserve a fair accounting of our stewardship.

After eight trips to Iraq, it's clear to me we've made progress and we've made mistakes. Our burden as well-intentioned liberators is this: The progress belongs to the people of Iraq. The mistakes are ours to remedy. Our management of the DFI has much to teach us about both.

Our witnesses will help provide essential substance and needed context to our discussion of the Development Fund for Iraq. We appreciate their time and expertise, and we look forward to their testimony.

Mr. KUCINICH. Mr. Chairman, if I may followup on what you just said, they do not have written testimony because they were dealing in cash.

I want to thank the Chair for calling this hearing and thank the witnesses for their presence. I am sure we are going to have a very interesting discussion this morning, especially since you do not have prepared testimony.

Now, if I may, it is interesting to begin with to talk about the redactions, because we learned through our subcommittee that redactions to the DCAA audits were made not by the Department of Defense but by a contractor, Kellogg, Brown and Root. It is going to be interesting to talk about that today.

It is also going to be interesting to talk about the finding, factual finding in connection with disbursements that six cases were found where contracting files could not be located, disbursements totaling $51 million; 19 cases where evidence of contract monitoring over the delivery of goods and performances of services were not documented in the contract file, $302 million; 1 case where a contractor increased the price of proposal by over $4 million, to include, in part, the accelerated delivery of equipment; 17 cases where there was no formal approval of funding for contracts or payments, payments of over $242 million; 10 cases where payments were authorized by only one industry; and 6 cases where payments were not authorized at all, $159 million.

Over 600 tons of Iraqi oil worth $69 million produced between July 29, 2004, and December 31, 2004, according to this report, missing.

This committee is one of several in Congress currently scrutinizing every record and meeting related to the United Nations' stewardship of Oil-for-Food Program in Iraq. This is the first time that any committee in Congress has looked at the United States' own financial management in Iraq of the successor to that program, the development fund for Iraq.

Let's dispel the myth right now. There was no multi-national control of the Coalition Provisional Authority. It was the United States in charge of the Coalition Provisional Authority's existence and both the Coalition Provisional Authority and Department of Defense bear responsibility for their actions.

I will also note that, while you do not have testimony, you also do not have the former head of the Coalition Provisional Authority, Bob Bremer, here. He apparently did not feel it was necessary for public accounting and to appear before the subcommittee today or to send any representatives to explain his actions or the actions of the CPA, and if we did not request Mr. Bremer be here, then perhaps at a future hearing we could get his presence.

So it is left to this subcommittee and the Special Inspector General for Iraq Reconstruction, who is with us today, to track down what happen to the CPA's disbursal of billions of dollars of Iraq's DFI funds. What we found is alarming: hardly any accountability. In effect, we are handing out $100 bills in contracts like candy.

There are $8.8 billion in DFI funds disbursed to Iraq ministries that are still unaccounted for, and to take a step back to look at a bigger picture, that $8.8 billion represents only a portion of the DFI funds. There are over $23 billion in Iraqi funds that the Coali-

tion Provisional Authority had responsibility for and neglected to account for properly. Furthermore, of that $23 billion, the CPA spent or obligated almost all of it, over $19 billion, before handing the Iraqi government back to the Iraqis. Bear in mind that much of that money went to U.S. contractors in Iraq, another topic that will be highlighted today and merits further investigation.

In the Special Inspector General's report on DFI disbursements to interim Iraqi government ministries dated January 30, 2005, he noted that the CPA's operations totally lacked transparency and proper accounting controls. The Special IG wrote, "The CPA provided less-than-adequate controls for approximately $8.8 billion in DFI funds provided to Iraqi ministries through the national budget process. Specifically, 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 Resolution 1483." Let me repeat, "There was no assurance that funds were used for the purposes mandated by Resolution 1483."

The Special Inspector General report concluded that, "We believe the CPA management of Iraq's national budget process and oversight of Iraqi funds was burdened by severe inefficiencies and poor management."

Where did the $9 billion go? We know that of a sample review of the IG of 10 disbursements made by the CPA comptroller's office ranging from $120 million to $900 million in value, none of the disbursements included basic spending plans. Where was the money spent? Was it stuffed in briefcases? Did it go to the salaries of ghost employees who we paid? The CPA paid cash to 8,026 Iraqi protective guards on the payroll at one ministry, but the Special IG could only verify that 602 actually existed. At another ministry, 1,471 guards were on the payroll, but only 642 guards could be verified.

The CPA and the DOD argue that proper controls and accounting could not be put into place because this is a wartime environment. I see this as nothing more than a self-serving excuse that we would never tolerate if it came from a multilateral agency, for instance. The sanctimony animating criticism of the U.N. Oil-for-Food Program and threats of withholding U.N. dues is noteworthy here.

Here we have a matter that is within the sole control of Congress: the scandalous mismanagement of the United States of the Iraqi's financial resources. Through systematic mismanagement, a lack of transparency, the U.S. occupation of Iraq has discredited the United States and I feel has brought shame on our Nation. So, Mr. Chairman, I hope we do not hear any more flimsy excuses from the administration today.

I want to thank the Chair for working with the minority on this issue and hope that our tough questions today lead to far tougher controls and improved accountability in Iraq.

I yield back.

Mr. SHAYS. I thank the gentleman.

[The prepared statement of Hon. Dennis J. Kucinich follows:]

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For Immediate Release:
Tuesday, June 21, 2005

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Statement Of Congressman Dennis J. Kucinich

Congressman Dennis J. Kucinich (D-OH), Ranking Democrat on the House Government Reform Subcommittee National Security, Emerging Threats and International Relations, issued the following statement today at the Subcommittee hearing on the missing $9 billion of Iraqi reconstruction money:

Good morning. I want to start by thanking the Chairman for calling this hearing today at my request.

While this committee is one of several in Congress currently scrutinizing every record and meeting related to the United Nation's stewardship of the Oil for Food Program in Iraq, this is the first time that any committee in Congress has looked at the United States' own financial management in Iraq of the successor to that program, the Development Fund for Iraq (DFI). I am pleased that the Chairman recognizes that Congress has an obligation to root out waste, fraud, and abuse, particularly given the hundreds of billions of dollars that Congress has appropriated towards rebuilding Iraq.

Let's dispel the myth right now - there was no multinational control of the Coalition Provisional Authority (CPA) - it was the United States in charge the entire time of the CPA's existence, and both the CPA and DOD bear responsibility for their actions there. I will also note that the former head of the CPA, Paul Bremer, did not feel it was necessary to appear before the committee today, or to send any representatives to explain their actions.

So it is left to this Committee and the Special Inspector General for Iraq Reconstruction, who is with us today, to track what happened in the CPA's disbursal of billions of dollars of Iraqi DFI funds.

What we've found is alarming. There was hardly any accountability - we were handing out $100 bills and contracts like candy. $8.8 billion in DFI funds disbursed to Iraqi ministries are still unaccounted for. And to take a step back to look at the bigger picture, that $8.8 billion only represents a portion of the DFI funds; there were over $23 billion in Iraqi funds that the CPA had responsibility over, and neglected to account for properly. Furthermore, of that $23 billion, the CPA spent or obligated almost all of it - over $19 billion - before handing the Iraqi government back to the Iraqis. Bear in mind that much of that money went to U.S. contractors in Iraq, another topic that will be highlighted today and merits further investigation.

In the Special Inspector General's report on DFI disbursements to Interim Iraqi Government ministries, dated January 30, 2005, he noted that the CPA's operations totally lacked transparency and proper accounting controls.

The Special IG wrote,
"The CPA provided less than adequate controls for approximately $8.8 billion in DFI funds provided to Iraqi ministries through the national budget process. Specifically, 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 Resolution 1483."

--over--

Mr. SHAYS. At this time the Chair would recognize the former vice chairman of this subcommittee, Mr. Turner.

Mr. TURNER. Thank you, Mr. Chairman. I want to thank you for holding this important hearing today. The effort and the process of the oversight of the Iraqi construction process and of these programs is incredibly important. It certainly is concerning in reading the staff report concerning the level of cooperation that this committee has received.

The process of oversight is important so that we can make certain as Americans that our country is doing the best that we can. Not only is our reputation on the line, but the safety of Americans that are in the Middle East and are serving in Iraq is on the line.

Our ability to defend our processes and what we are doing is important, just as the rules and regulations and processes under which we operate is important. It is very concerning, when you look in the report from our staff, concerning the level of cooperation that we are receiving. And this chairman has been to Iraq eight times and he has been a champion of the reconstruction of Iraq and of this committee's support for oversight and support for DOD's operations and trying to get out the good news of the process of what is being accomplished.

It certainly does cause people to pause when Congress in its oversight function is not being treated as a partner. I certainly hope that during this hearing that we see that partnership and that we see the types of information that is necessary for the good news of the effort to have the Iraqi oil proceeds program operated effectively and for the benefit of the Iraqi people.

Thank you.

Mr. SHAYS. I thank the gentleman.

At this time the Chair would recognize the ranking member for the full committee, Mr. Waxman.

Mr. WAXMAN. Thank you very much, Mr. Chairman. Today our subcommittee is holding a hearing on the development fund for Iraq. This is an important and overdue hearing. U.S. mismanagement of the DFI is one of the biggest untold stories of the war in Iraq.

After U.S. forces invaded Iraq in 2003, the U.N. Security Council created the DFI to hold Iraq's oil revenues and other assets, and the Security Council gave the U.S. officials authority to use the DFI for the benefit of the Iraqi people. Since then, U.S. officials have spent or disbursed over $19 billion of Iraqi money in the DFI, and there has been virtually no congressional oversight and little public understanding of these enormous expenditures.

I want to begin my remarks by commending Chairman Shays for holding this hearing. Today's hearing is the first congressional hearing on the DFI and how U.S. officials manage and mismanage the Iraqi assets in the fund. Chairman Shays has asked hard questions and approached today's hearing with an open mind and a spirit of bipartisanship.

The DFI is closely related to the Oil-for-Food Program. The DFI, which was run by the United States, is the successor for the Oil-for-Food Program which was run by the United Nations. In fact, over $8 billion in the Oil-for-Food Program was transferred into the DFI by the U.N. Security Council. Yet, there has been a stark and

telling contrast between Congress' approach to the Oil-for-Food Program and the DFI. Five separate congressional committees have been investigating U.N. mismanagement of the Oil-for-Food Program, more than a dozen hearings have been held, but before today there was not a single hearing in Congress of U.S. mismanagement of the development fund for Iraq. This neglect of the DFI has come at a steep cost to both congressional and public understanding of the actions of U.S. officials.

My staff has prepared a report that provides a comprehensive analysis of what is known about the DFI expenditures. The report is based on review of over 14,000 pages of financial records subpoenaed from the Federal Reserve Bank, 15,000 pages of documents from the Defense Department, reports from multiple U.S. audit agencies, and interviews with international investigators, U.S. agency representatives, and Iraqi officials. I ask that this report be made part of the hearing record.

Mr. SHAYS. Without objection, this report will be made part of the record.

[The information referred to follows:]

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON GOVERNMENT REFORM — MINORITY STAFF
SPECIAL INVESTIGATIONS DIVISION
JUNE 2005

REBUILDING IRAQ
U.S. MISMANAGEMENT OF IRAQI FUNDS

PREPARED FOR

REP. HENRY A. WAXMAN

WWW.DEMOCRATS.REFORM.HOUSE.GOV

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Between March 19, 2003, when U.S. forces invaded Iraq, and June 28, 2004, when the U.S.-run Coalition Provisional Authority turned power over to the interim Iraqi government, U.S. officials disbursed or obligated over $19.6 billion in Iraqi funds. The vast majority of these funds were withdrawn from the Development Fund for Iraq, the successor to the U.N. Oil for Food Program, while others came from frozen and seized Iraqi assets. Yet despite the magnitude of the sums involved, there has been little scrutiny of how U.S. officials managed the Iraqi assets entrusted to their care.

At the request of Rep. Henry Waxman, this report examines U.S. management of these Iraqi funds. It is based on a review of over 14,000 pages of financial records and other documents from the Federal Reserve; over 15,000 pages of documents from the Department of Defense; audit reports from the Special Inspector General for Iraq Reconstruction, the Defense Contract Audit Agency, the Government Accountability Office, and other auditors; and interviews with auditors, federal officials involved in the management or disbursement of the Iraqi funds, and Iraqi officials.

The report has three principal findings: (1) unprecedented sums of cash were withdrawn from Iraqi accounts at the Federal Reserve Bank in New York and transferred to U.S. officials at the CPA; (2) CPA officials used virtually no financial controls to account for these enormous cash withdrawals once they arrived in Iraq; and (3) there is evidence of substantial waste, fraud, and abuse in the actual spending and disbursement of the Iraqi funds.

Billions in Cash Withdrawals

The documents from the Federal Reserve indicate that the United States shipped nearly $12 billion in U.S. currency to Iraq between May 2003 and June 2004, an international currency transfer of unprecedented scale. The cash was drawn from accounts containing revenues from sales of Iraqi oil and frozen and seized assets of the former regime.

Nearly half of the currency shipped into Iraq under U.S. direction — more than $5 billion — flowed into the country in the final six weeks before control of Iraqi funds was returned to the interim Iraqi government on June 28, 2004. In the week before the transition, CPA officials ordered the urgent delivery of more than $4 billion in U.S. currency from the Federal Reserve, including one shipment of $2.4 billion — the largest shipment of cash in the bank's history.

In total, more than 281 million individual bills — including more than 107 million $100 bills — weighing 363 tons were shipped to Iraq.

Lack of Financial Controls

Once the cash from the Federal Reserve arrived in Iraq and came under the control of U.S. officials at the Coalition Provisional Authority, the cash was spent and disbursed with virtually no appropriate financial controls.

Under the terms of the U.N. resolution creating the Development Fund for Iraq, the fund was to be used "in a transparent manner to meet the humanitarian needs of the Iraqi people … and for other purposes benefiting the people of Iraq." But no certified public accounting firm was hired to audit disbursements, and hundreds of millions of dollars in overcharges were withheld from international auditors. According to the Special Inspector General for Iraq Reconstruction, U.S. officials cannot account for the spending of billions of dollars in cash.

An official involved in the spending and disbursement of the Iraqi proceeds described an environment awash in $100 bills. One contractor received a $2 million payment in a duffel bag stuffed with shrink-wrapped bundles of currency. Auditors discovered that the key to a vault was kept in an unsecured backpack. They also found that $774,300 in cash had been stolen from a vault. Cash payments were made from the back of a pickup truck, and cash was stored in unguarded sacks in Iraqi ministry offices. One official was given $6.75 million in cash and ordered to spend it in one week, before the interim Iraqi government took control of Iraqi funds.

Evidence of Waste, Fraud and Abuse

Because of the lack of proper financial controls, there is no reliable accounting of how the Iraqi funds under U.S. control were spent or disbursed. There is, however, evidence that the expenditure and disbursement of these funds was characterized by significant waste, fraud, and abuse.

Examples of wasteful and potentially corrupt spending include the following:

- The largest single recipient of Iraqi funds is Halliburton, which received $1.6 billion in Iraqi oil proceeds under a contract to import fuel and repair oil fields. According to DCAA auditors, Halliburton's overcharges under this contract are more than $218 million.

- An inexperienced but politically connected security firm, Custer Battles, received over $11 million in Iraqi funds, including over $4 million in cash. The company has been barred from receiving federal contracts and faces a False Claims Act lawsuit for multiple fraudulent billings.

- Over $600 million in cash was shipped from Baghdad to four regions in Iraq to allow commanders flexibility to fund local reconstruction projects. An audit of one of the four regions found more than 80% of the funds

could not be properly accounted for and that over $7 million in cash was simply missing.

- CPA officials gave over $8 billion in cash to Iraqi ministries that had no internal or financial controls in place to handle such an influx of funds. The Special Inspector General found significant funds that appeared to be paid to "ghost employees" and billion-dollar discrepancies in some expenditures.

Need for Further Investigation

The findings in this report underscore the need for a comprehensive investigation into how the United States spent and disbursed billions of dollars in Iraqi funds. There is substantial evidence of widespread mismanagement, waste, and corruption in the spending and disbursement of over $19.6 billion in Iraqi funds during the period of U.S. control. The full extent of the waste, fraud, and abuse will not be known without additional investigation.

I. BACKGROUND

On March 20, 2003, President Bush issued an executive order transferring Iraqi assets, held in U.S. banks and frozen since Iraq's invasion of Kuwait, to a U.S. Treasury Special Purpose Account (TSPA) established at the Federal Reserve Bank of New York.[1] Two months later, United Nations Security Council Resolution 1483 established the Development Fund for Iraq (DFI) to hold the proceeds of Iraqi oil sales, Iraqi assets frozen in bank accounts outside of the United States, and $8.1 billion in funds transferred from the U.N.-administered Oil-for-Food program.[2] Control over these two funds — as well as over cash from the former Iraqi regime seized within Iraq — was given to the U.S.-run Coalition Provisional Authority.

The President's executive order and the subsequent Security Council resolution directed that these funds were to be used by the CPA for the benefit of the Iraqi people. The assets of the former Iraqi government — the "ill-gotten gains of Saddam Hussein and his regime" — was "Iraqi money" that should be returned to the Iraqi people to provide for their "benefit and welfare."[3] Under the terms of the Security Council resolution, these funds were to be used "in a transparent manner to meet the humanitarian needs of the Iraqi people … and for other purposes benefiting the people of Iraq."[4]

On June 10, 2003, CPA Administrator L. Paul Bremer issued Regulation Number 2, which governed the DFI and provided:

> [This] Regulation is intended and shall be applied to ensure that the Fund is managed in a transparent manner for and on behalf of the Iraqi people,

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1 U.S. Department of the Treasury, *Fact Sheet* (Mar. 20, 2003) (online at http://www.treas.gov/press/releases/docs/sheet.pdf).

2 United Nations Security Council, *Resolution 1483* (May 22, 2003) (online at http://www.un.org/News/dh/iraq/iraq-blue-res-052103en.pdf); Coalition Provisional Authority, *Development Fund for Iraq Financial Reporting Matrix as of June 28, 2004* (Aug. 3, 2004).

3 U.S. Department of the Treasury, *Fact Sheet* (Mar. 20, 2003) (online at http://www.treas.gov/press/releases/docs/sheet.pdf).

4 U.N. Security Council Resolution 1483.

> consistent with Resolution 1483, and that all disbursements from the Fund are for purposes benefiting the people of Iraq.[5]

Shortly thereafter, Ambassador Bremer wrote in one of his first directives:

> As steward for the Iraqi people, the CPA will manage and spend Iraqi funds, which belong to the Iraqi people, for their benefit … .[T]hey shall be managed in a transparent manner that fully comports with the CPA's obligations under international law, including Resolution 1483.[6]

In order to monitor U.S. actions involving the Iraqi funds, U.N. Security Council Resolution 1483 established the International Advisory and Monitoring Board (IAMB) to ensure that the DFI "is used in a transparent and equitable manner."[7] The IAMB includes representatives from the United Nations, Arab Fund for Economic and Social Development, International Monetary Fund, and World Bank.[8] To fulfill its oversight role, the IAMB was authorized to retain independent public accountants to conduct external audits and monitor the internal controls of the DFI. On April 5, 2004, the IAMB named KPMG as the external auditor.[9]

Congress also established a body to oversee the expenditures of the funds: the Inspector General of the Coalition Provisional Authority.[10] Authority for the CPA Inspector General was to terminate six months after the dissolution of the CPA, which occurred on June 28, 2004. However, Congress amended the original authorization to redesignate the CPA Inspector General as the Special Inspector General for Iraq Reconstruction and to extend the life of the Special Inspector General's authority.[11]

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5 Coalition Provisional Authority, *Regulation No. 2: Development Fund for Iraq* (June 18, 2004).

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

7 IAMB Press Release, *Establishment of the International Advisory and Monitoring Board: Terms of Reference* (Oct. 24, 2003).

8 IAMB, *Curriculum Vitae of IAMB Representatives and IAMB Alternate Representatives*, at http://www.iamb.info.

9 IAMB Press Release, *Statement by the International Advisory and Monitoring Board on Iraq* (Apr. 5, 2004).

10 Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, §3001, Pub. L. No. 108-106.

11 National Defense Authorization Act for FY 2005, Pub. L. No. 108-375.

As of June 28, 2004, the date that the CPA transferred authority over the DFI to the interim Iraqi government, $20.7 billion had been deposited into the DFI.[12] During the CPA's control of Iraq, it disbursed $14 billion in DFI assets and obligated another $3.1 billion, leaving a $3.5 billion balance transferred to Iraqi control.[13] In the same period, approximately $1.9 billion was deposited into the TSPA, of which $1.7 billion was disbursed in cash shipments to Iraq and $210 million transferred to the DFI (included in the DFI totals above).[14] Coalition military forces seized $926.7 million in cash from the former regime, and the CPA obligated or expended $774.4 million of that amount.[15]

In total, the CPA controlled $23.3 billion in Iraqi funds and spent or disbursed $19.6 billion. Of the amount expended, almost two-thirds — more than $12.7 billion — was disbursed in cash. Figure 1.

FIGURE 1: Iraqi Funds Under Coalition Provisional Authority Control
(rounded to thousands)

Deposits	
Development Fund for Iraq:	$20,706,395,000
Treasury Special Purpose Account:	$ 1,916,496,000
Seized Iraqi Cash	$ 926,700,000
(Transfer from TSPA to DFI)	*($ 208,564,000)*
Total Iraqi deposits under U.S. control:	$23,341,027,000
Withdrawals	
Disbursements from DFI:	$14,058,659,000
Cash shipped to Iraq from TSPA:	$ 1,707,931,000
Seized cash disbursed or obligated:	$ 774,400,000
Commitments from DFI:	$ 3,104,909,000
Total amount disbursed or obligated by U.S.:	$19,645,899,000
Balance	
Transferred from CPA to interim Iraqi govt:	$ 3,695,128,000

12 Coalition Provisional Authority, *Development Fund for Iraq Financial Reporting Matrix as of June 28, 2004* (Aug. 3, 2004).

13 *Id.*

14 Federal Reserve Bank of New York, *Summary: Special Currency Shipments to Iraq*; Letter from Federal Reserve Bank of New York to Minority Staff (Feb. 15, 2005).

15 Special Inspector General for Iraq Reconstruction, *Quarterly and Semiannual Report to the United States Congress*, 58 (July 30, 2004).

II. PURPOSE AND METHODOLOGY

Although Congress has conducted an extensive investigation of mismanagement in the U.N.-administered Oil-for-Food program, holding at least 13 hearings on the subject, Congress has, until now, failed to similarly review the U.S. administration of Iraqi assets and revenues by the CPA.

As part of an effort to conduct such a review, the Committee on Government Reform obtained documents from the Federal Reserve Bank of New York and the Department of Defense. Committee staff reviewed over 14,000 pages of financial records and other documents from the Federal Reserve and over 15,000 pages of documents from the Department of Defense. These documents show that billions of dollars of DFI and TSPA funds were shipped to Iraq in the form of United States currency, for disbursement by the CPA to Iraqi ministries and CPA contractors.

Committee staff reviewed all available audit reports addressing the expenditure of the Iraqi funds. These audit reports included reports from the Special Inspector General for Iraq Reconstruction, the Defense Contract Audit Agency, the U.S. Army Audit Agency, and the Government Accountability Office. Committee staff also reviewed letters issued by KPMG, the audit firm hired by the IAMB, as well as statements and meeting minutes from the IAMB.

Committee staff met with Stuart Bowen, Jr., the Special Inspector General for Iraq Reconstruction (formerly CPA Inspector General), officials from the Army Corps of Engineers, and William Reed, Director of the Defense Contract Audit Agency. The minority staff interviewed Frank Willis, a former senior CPA official, and reviewed reports from other CPA officials. The staff also reviewed records of congressional hearings and published media accounts.

A. The Federal Reserve Shipped Nearly $12 Billion in U.S. Currency to Iraq

The Federal Reserve shipped $11,981,531,000 in U.S. currency to Iraq between May 2003 and June 2004, according to documents from the Federal Reserve Bank of New York.[16] The cash was drawn from the DFI and TSPA accounts containing revenues from sales of Iraqi oil and frozen and seized assets of the former regime. The CPA also controlled $926,700,000 in U.S. currency seized within Iraq, mainly from the vaults of the former regime.[17]

This currency was shipped to Iraq on pallets loaded into C-130 cargo planes. A standard pallet of U.S. currency contains 40 "cashpaks" of 16,000 bills each and weighs 1,500 pounds.[18] In the thirteen months that the United States administered the DFI and TSPA, 484 pallets containing 19,360 cashpaks were shipped from New York to Iraq.[19] These pallets held more than 281 million individual bills, weighing 363 tons.[20] In total, the U.S. shipped to Iraq more than 107 million $100 bills.[21]

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16 Federal Reserve Bank of New York, *Summary: Special Currency Shipments to Iraq*; Letter from Federal Reserve Bank of New York to Minority Staff (Feb. 15, 2005).

17 Special Inspector General for Iraq Reconstruction, *Quarterly and Semiannual Report to the United States Congress*, 58 (July 30, 2004).

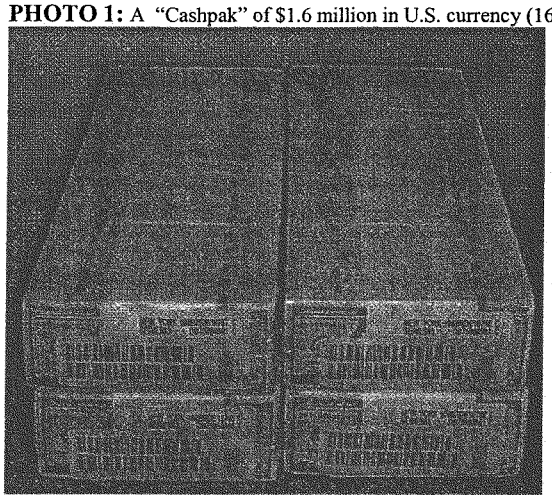
18 Federal Reserve Bank of New York, *Summary: Special Currency Shipments to Iraq*; Letter from Federal Reserve Bank of New York to Minority Staff (Feb. 15, 2005).

19 *Id.*

20 *Id.*

21 *Id.*

PHOTO 1: A "Cashpak" of $1.6 million in U.S. currency (16,000 $100 bills).



According to internal Federal Reserve Bank records, CPA officials who controlled the DFI and TSPA ordered an initial shipment of currency to Iraq in April 2003, comprising $20,008,000 in $1, $5, and $10 bills.[22] Over the next two months, the shipments became larger: $179,340,000 in May 2003 and $465,920,000 in June 2003. Cash shipments from New York into Iraq continued at an average rate of once or twice a month for the rest of the year: $391,200,000 in July, $808,200,000 in August, $400,000,000 in September, $463,975,000 in October, and $500,000,000 in November.

The December 12, 2003, shipment was markedly larger — $1.5 billion — and was described by a Federal Reserve official in an e-mail message as "the largest pay out of U.S. currency in Fed history."[23]

In 2004, the shipments became more regular. The records show shipments of $750,400,000 in February, March, and April. As the CPA prepared to transfer

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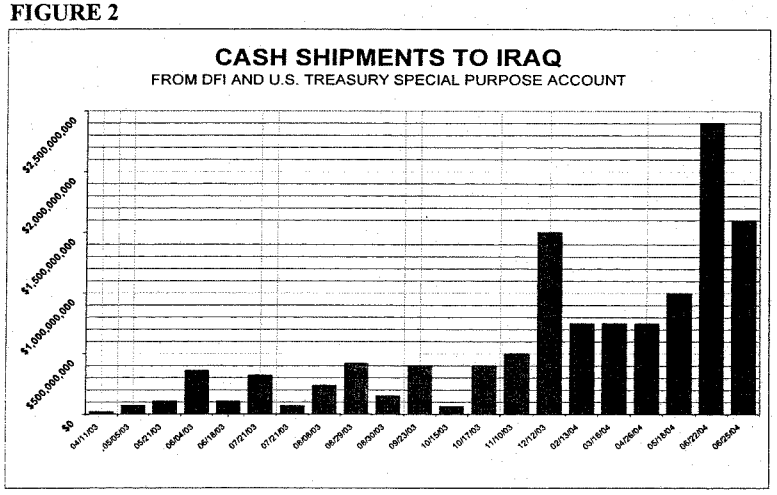
22 Federal Reserve Bank of New York, *Summary: Special Currency Shipments to Iraq*; Letter from Federal Reserve Bank of New York to Minority Staff (Feb. 15, 2005).

23 E-mail from Robert Kraus to Joseph Botta (Dec. 12, 2003) (DFI-Cash00220)

authority to the interim Iraqi government, however, the scale of shipments increased suddenly and sharply: $1 billion was shipped in May 2004, followed by two massive shipments totaling more than $4 billion in the week before the transfer of sovereignty.

FIGURE 2



In the words of one Federal Reserve official, "Just when you think you've seen it all … the CPA is ordering $2,401,600,000 in currency to be shipped out on Friday June 18th."[24] While the Federal Reserve was preparing this shipment, the CPA pushed back the delivery date, and requested an additional shipment:

> The new date is 22 June departure with arrival/delivery on 23 June. **It is important that we make these dates as we have little flex. HEADS UP!** We are going to request a second mission for a 28 June delivery.[25]

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24 E-mail from Timothy Fogarty to Dino Kos (June 11, 2004) (FRBNY 003949 DFI-Email).

25 E-mail from LTC Bill McQuail to Tina Smith, quoting COL Don Davis (June 15, 2004) (DFI-LGL000607) (emphasis in original).

A Federal Reserve official confirmed the delivery: "I checked the dates with Col Davis and yes, they want delivery to Baghdad on Monday [June 28]."[26] However, a Monday delivery to Baghdad would have required the Federal Reserve to take the unusual step of opening its vaults on a Sunday. The Federal Reserve and CPA sought to avoid that problem:

> [T]he CPA is now asking if INSTEAD OF doing the Sunday 6/27 shipment, we can ADD $1 bn to the already-scheduled Tuesday 6/22 shipment. If that is do-able, it avoids the whole Sunday accounting problem … but also makes it a **$3 bn** shipment … if the USAF [U.S. Air Force] agrees to do it, I would like to give the CPA an answer today on our ability to put another $1 bn in $100's on the plane."[27]

In an e-mail with the subject "RE: Pocket Change," a CPA official again emphasized the need to push the schedule ahead: "We need to work the second mission as originally planned to arrive on 26th if at all possible. The 27th at latest. I am not sure we can get anything in here from the 28th through the 5 July. We have been ordered to limit travel out of the green zone between 28 June and 5 July. I am just hoping we don't have to back this date up."[28]

Ultimately, the last-minute cash was sent to Iraq in two separate shipments: $2,401,600,000 on June 22, 2004, and $1,600,000,000 on June 25, 2004. The $2.4 billion delivered on these days replaced the December 2004 shipment as the largest pay out of U.S. currency in Fed history.

In total, nearly $12 billion in cash flowed into Iraq. Of this amount, nearly half — more than $5 billion — was shipped into the country in the month before the transition. Figure 3.

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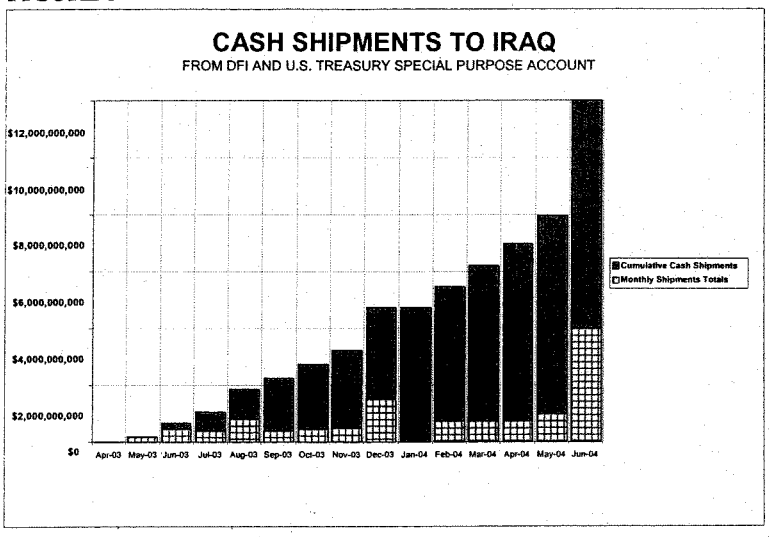
26 E-mail from Marybeth Butkus to Timothy Fogarty (June 16, 2004) (DFI-LGL000606).

27 E-mail from Timothy Fogarty to Felicia Wiggin (June 18, 2004) (FRBNY 003912 DFI-Email) (emphasis in original).

28 E-mail from COL Don Davis LTC Herman Asberry (June 20, 2004) (DFI-LGL000598)

FIGURE 3



The last-minute rush to spend Iraqi funds was halted by the Federal Reserve when the CPA transferred sovereignty to the interim Iraqi government on June 28, 2004, two days earlier than had been scheduled. After the transfer on the morning of June 28, CPA officials twice sought additional withdrawals from the Federal Reserve accounts, but these were rebuffed. The documents show that the Federal Reserve took:

> a strong view that effective as of the time AMB Bremer transferred authority (which is being reported in the press as 10:26 am in Baghdad), the CPA no longer had control over Iraq's assets. ... [S]ubsequent to transfer of sovereignty, COL Davis of the CPA sent us $200 million in payment orders to be executed today in New York. We have informed the Colonel that we are not in a position to honor these instructions. Second, also subsequent to the transfer of sovereignty, COL Davis sent us an instruction to transfer $800 million from the DFI main account into the new DFI subaccount, which we understand informally was created by AMB Bremer to hold funds that are ear marked internally within Iraq for payments connected to existing contracts. We have also informed COL

> Davis that we are not in a position to honor this instruction either (especially since it would require liquidating $1 billion worth of the CBI's [Central Bank of Iraq] holdings of USG [U.S. Government] securities.[29]

B. The CPA Failed to Provide Adequate Financial or Physical Controls

Once the nearly $12 billion in cash arrived in Iraq, the cash was placed under the control of U.S. officials at the Coalition Provisional Authority. Contrary to the requirements of the U.N. Security Council resolution and its own regulations, however, the CPA spent and disbursed the cash without appropriate financial or security controls. According to the Special Inspector General for Iraq Reconstruction, the result is that literally billions of dollars cannot be properly accounted for.

In June 2003, the CPA issued a regulation requiring that "an independent, certified public accounting firm" oversee the expenditures of the Iraqi funds. The regulation directed:

> The CPA shall obtain the services of an independent, certified public accounting firm to support the objective of ensuring that the Fund is administered and used in a transparent manner for the benefit of the people of Iraq, and is operated consistent with Resolution 1483.[30]

On April 20, 2004, however, CPA officials reported that the "CPA did not obtain the services of a certified public accounting firm as it was determined that these services were not those required."[31] Instead, the CPA hired an obscure consulting firm called North Star Consultants, Inc., "to promote the effective administration of DFI Funds in a transparent manner for the benefit of the Iraqi people."[32] The firm is so small that it reportedly operates out of a private home near San Diego.[33]

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29 E-mail from Michael Silva to Larry McDonald (June 28, 2004) (DFI-CBIAS0000199).

30 Coalition Provisional Authority, *Regulation Number 2: Development Fund for Iraq* (June 10, 2003).

31 Email from Greg McCarthy, Coalition Provisional Authority, to Minority Staff, House Government Reform Committee (Apr. 20, 2004).

32 *Id.*

33 *"What happened to Iraq's oil money?"* NBC News (Nov. 30, 2004).

When the Special Inspector General for Iraq Reconstruction audited North Star's work, the Special Inspector General found that North Star did not perform any review of the CPA's internal controls:

> In October 2003 a $1.4 million contract was awarded to North Star Consultants, Inc. that required the contractor to perform a review of internal controls and provide the CPA a written report of their evaluation. The North Star Consultants did not perform a review of internal controls as required by the contract. Consequently, internal controls over DFI disbursements were not evaluated. In addition, the Comptroller verbally modified the contract and employed the contractor to primarily perform accounting tasks in the Comptroller's officer.[34]

The CPA also provided inadequate physical controls to safeguard the billions of dollars of U.S. currency shipped to Iraq, according to the Special Inspector General. In an audit report, the Special Inspector General described "several physical safeguard violations" observed during the audit.[35] In one example, the "CPA Comptroller did not have adequate control or access to their field safe" and "[t]he key was located in an unsecured backpack."[36] In another, "the disbursement officer left the room and lost prevue [sic] over the open safe."[37]

The IAMB found similar problems. One audit by KPMG reported that $774,300 in cash had been stolen from one division's vault.[38]

Frank Willis, a former CPA official, provided a first-hand account of the vast amounts of cash flowing through Iraq and the lack of financial and physical controls over the funds. During the second half of 2003, Mr. Willis served in Iraq as Deputy Senior Advisor to the Ministry of Transportation and Communications and as the CPA's senior aviation official. Mr. Willis explained that under CPA

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34 Special Inspector General for Iraq Reconstruction, *Coalition Provisional Authority Comptroller Cash Management Controls Over the Development Fund for Iraq*, Report No. 04-009 (July 28, 2004).

35 Special Inspector General for Iraq Reconstruction, *Audit Report: Coalition Provisional Authority Comptroller Cash Management Controls Over the Development Fund for Iraq*, Report No. 04-009 (July 28, 2004).

36 *Id.*

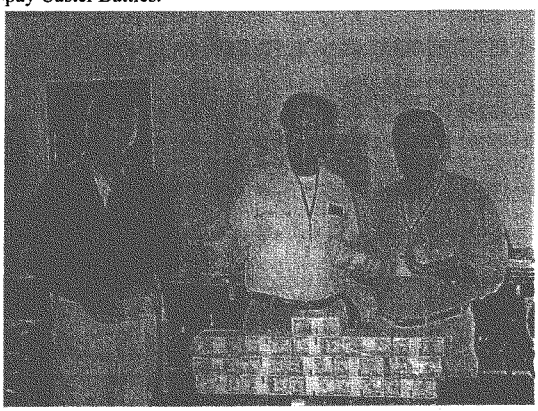
37 *Id.*

38 KPMG, *Development Fund for Iraq: Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004* at 6.2.13 (Oct. 14, 2004).

control, a "wild west" atmosphere prevailed and the country was awash in brand new $100 bills.[39]

According to Mr. Willis, when contractors needed to be paid by the CPA, they were told to "bring a big bag" for a cash payment.[40] Mr. Willis personally witnessed a $2 million payment to contractor Custer Battles in shrink-wrapped stacks of $100 bills retrieved from a vault.[41] Photo 2.

PHOTO 2: CPA officials standing with $2 million in cash used to pay Custer Battles.[42]



The Special Inspector General for Iraq Reconstruction reported that cash payments to Iraqi contractors and Iraqi ministries similarly lacked physical security. According to the Special Inspector General, cash payments to

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39 Testimony of Frank Willis, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, Senate Democratic Policy Committee (Feb. 14, 2005).

40 Interview of Frank Willis, Committee on Government Reform, Minority Staff (Jan. 27, 2005).

41 Senate Democratic Policy Committee, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, 109th Cong., 24 (Feb. 14, 2005).

42 Photo provided by Frank Willis

contractors were made from the back of a pickup truck, and cash was stored in unsecured gunnysacks in Iraqi ministry offices.[43]

Controls appeared to break down completely in the final days of CPA authority, just as billions of dollars in cash were being rushed into the country. A Special Inspector General audit found that CPA staff members were encouraged to spend cash quickly in its last days before the interim Iraqi government took control of the funds. In the South-Central region of Iraq, one disbursing official was given $6.75 million in cash on June 21, 2004, "with the expectation of disbursing the entire amount before the transfer of sovereignty" on June 28, 2004.[44]

The end result is that billions in Iraqi funds spent or disbursed by the CPA cannot be accounted for. The Special Inspector General concluded that "the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner" and that funds were "susceptible to waste, fraud, and abuse."[45] Although U.N. Security Council Resolution 1483 required that the Iraqi funds be administered "in a transparent manner," the lack of adequate financial and physical controls have made transparency and accountability virtually impossible.

C. There Is Mounting Evidence of Extensive Waste, Fraud, and Abuse

Due to the lack of proper controls, there is no reliable accounting of how the $19.6 billion in Iraqi funds was spent and disbursed during the period of U.S. control. There is, however, growing evidence that there was significant waste, fraud, and abuse of these Iraqi funds. Multiple audits of specific expenditures have found mismanagement, wasteful spending, and fraud.

1. Overcharges by Halliburton

The largest single recipient of DFI funds is Halliburton. Under a no-bid, monopoly contract with the U.S. Army Corps of Engineers, a Halliburton

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43 *Id.*

44 Special Inspector General for Iraq Reconstruction, *Control of Cash Provided to South-Central Iraq*, Report No. 05-006 (Apr. 30, 2005).

45 Special Inspector General for Iraq Reconstruction, *Control of Cash Provided to South-Central Iraq*, Report No. 05-006 (Apr. 30, 2005); Special Inspector General for Iraq Reconstruction, *Oversight of Funds Provided to Iraqi Ministries through the National Budget Process*, Report No. 05-004 (Jan. 30, 2005).

subsidiary, KBR, was paid approximately $2.5 billion for the importation of fuel for the Iraqi people, the preparation of oil field damage assessments, and the repair of oil facilities.[46] Of the $2.5 billion Halliburton received, $1.6 billion came from Iraqi funds from the DFI.

Halliburton's work in Iraq has been plagued by overcharges. According to audits prepared by the Defense Contract Audit Agency (DCAA), the company's overcharges under the oil contract exceed $218 million.[47] Of this amount, $177 million in overcharges were paid from funds in the DFI.[48]

In an audit of just one task order, to import fuel into Iraq from Kuwait, auditors criticized Halliburton's charges in nearly every area, including labor, material, subcontracts, overhead, and general and administrative expenses. The auditors found that these "noncompliances and inadequacies" were "significant" and concluded that "we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price."[49]

DCAA also detailed numerous specific problems with Halliburton's charges. The agency found that Halliburton had failed to demonstrate that its prices for Kuwaiti fuel were "fair and reasonable" and had failed to negotiate better prices with its

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

47 U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Oct. 7, 2004) (online at http://www.hq.usace.army.mil/CEPA/Iraq/ March03-table.htm) (calculated using amounts noted under each task order as funded through the DFI, seized Iraqi assets, and U.S. appropriated funds).

48 *Id.*; Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5 (Audit Report No. 3311-2004K17900055) (Oct. 8, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 6 (Audit Report No. 3311-2004K21000028) (Sept. 16, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 7 (Audit Report No. 3311-2004K21000007) (Sept. 17, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 8 (Audit Report No. 3311-2004K21000008) (Aug. 31, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 9 (Audit Report No. 3311-2004K21000011) (Aug. 30, 2004); Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 10 (Audit Report No. 3311-2004K21000012) (Aug. 31, 2004).

49 *Id.* at 5.

Kuwaiti subcontractor.[50] In addition, Halliburton repeatedly refused to provide information requested by DCAA auditors, including its actual costs for fuel from Turkey and Jordan and the process it used to choose its Kuwaiti subcontractor.[51]

Although Security Council Resolution 1483 requires "transparency," U.S. officials affirmatively sought to withhold information about Halliburton's overcharges from the IAMB. After failing for months to respond to repeated requests by the IAMB for DCAA's audits, U.S. officials finally provided the IAMB with "redacted copies of the DCAA audit reports on sole sourced contracts, at its meeting in October 2004."[52] These audits were so heavily redacted, however, as to be nearly meaningless. Every reference to every overcharge in every audit submitted to the IAMB was blacked out. In total, references to overcharges and other questioned costs were redacted 463 times by Halliburton and U.S. officials.[53]

2. Fraud by Custer Battles

In July 2003, a newly formed U.S. security firm with political connections, Custer Battles, was awarded a $16.8 million sole-source contract to provide security at Baghdad International Airport.[54] In August 2003, the company also received a $21.3 million contract to provide security for the exchange of Iraqi currency.[55] One of the principals in the company, Michael Battles, was a Republican candidate for Congress in Rhode Island in 2002 with White House ties.[56] In addition to receiving millions of dollars in wire transfer payments from the DFI, Custer Battles also received over $4 million in cash from the CPA's vault in Baghdad.[57] According to the minutes of a Program Review Board meeting in

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50 Defense Contract Audit Agency, Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5 (Audit Report No. 3311-2004K17900055) (Oct. 8, 2004).

51 *Id.*

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

53 Letter from Rep. Henry A. Waxman to Rep. Christopher Shays (Apr. 11, 2005).

54 Special Inspector General for Iraq Reconstruction, *Quarterly and Semiannual Report to the United States Congress*, K-2 (Jan. 30, 2005).

55 *Id.*

56 Griff Witte, *Lawmakers Told About Contract Abuse in Iraq*, Washington Post (Feb. 15, 2005).

57 Federal Reserve Bank, Iraqi Wire Payments spreadsheet (#77711); Testimony of Alan Grayson, An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq, Senate Democratic Policy Committee (Feb. 14, 2005).

Baghdad, the decision to award the airport security contract to Custer Battles was made only after "Homeland Security (stateside) agreed with selection of Custer Battle."[58]

The performance of Custer Battles appears to be rife with waste, fraud, and abuse. In just one example, Custer Battles allegedly seized forklifts from Baghdad airport abandoned by Iraqi Airways, repainted them to cover the Iraqi Airways markings, claimed the forklifts were owned by a Cayman Islands shell company created by Custer Battles, and billed the government to lease the same forklifts under the currency exchange contract.[59]

At a meeting between U.S. officials and Custer and Battles, a Custer Battles representative accidentally left behind a spreadsheet detailing the amounts that Custer Battles had overcharged the government.[60] Government investigators subsequently verified that Custer Battles "fraudulently increased profits by inflating its claimed costs."[61]

The company has been barred from receiving federal contracts,[62] and it is now facing a federal lawsuit under the False Claims Act.[63]

3. Irregularities and Fraud in the Commanders' Funds

Over $600 million in Iraqi funds were used by the CPA to establish the Commanders' Emergency Response Program (CERP) and the Rapid Regional Response Program (RRRP). These programs, which were controlled by military commanders and civilian officials in the field, were designed to fund local and regional reconstruction projects, create local jobs, support local industries, and

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58 Coalition Provisional Authority, Program Review Board Meeting Minutes (Aug. 5, 2003).

59 Amended Complaint, *United States ex rel. DRC, Inc. v. Custer Battles, LLC*, CV-04-199-A (E.D. Va. Aug. 26, 2004).

60 Testimony of Alan Grayson, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, Senate Democratic Policy Committee (Feb. 14, 2005).

61 Department of the Air Force, *Memorandum in Support of the Suspensions of Custer Battles, LLC et al.* (Sep. 20, 2004).

62 *Id.*

63 Testimony of Alan Grayson, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, Senate Democratic Policy Committee (Feb. 14, 2005).

stimulate the economy. In total, the CPA allocated $637 million in cash from the Iraqi funds to four regions through the CERP and RRRP programs.[64]

The Special Inspector General audited the cash control procedures in one of the four regions — the South-Central Region — that received CERP and RRRP funds. The audit found serious deficiencies that required "prompt attention and separate reporting."[65] According to the Special Inspector General, "These deficiencies were so significant that we were precluded from accomplishing our stated objectives."[66]

The South-Central region disbursed $119.9 million in Iraqi funds. But the Special Inspector General found that the CPA could not account for the expenditure of $96.6 million — 80% of the funds — and "there was no assurance that fraud, waste, and abuse did not occur in the management and administration of cash assets."[67] Of the $96.6 million that could not be accounted for, $7.2 million in cash remains missing.[68]

Moreover, the Special Inspector General found evidence of fraud and referred cases to the United States Attorney for prosecution. In one of these cases, two agents who were entrusted with cash left Iraq without accounting for their balances of $777,050 and $715,000. Rather than report the missing cash, an account manager simply adjusted the accounts to remove the outstanding balances.[69]

4. Irregularities and Corruption in Disbursements to Iraqi Ministries

CPA officials transferred $10.9 billion in DFI assets to Iraqi ministries. Of this amount, the Special Inspector General tried to audit how $8.8 billion in cash was expended. The Inspector General reported that these funds were transferred to Iraqi ministries without proper oversight or accounting controls. This large-scale transfer of funds to agencies with no capacity to efficiently administer them

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64 Special Inspector General for Iraq Reconstruction, Quarterly and Semiannual Report to the United States Congress, 60 (July 30, 2004).

65 Special Inspector General for Iraq Reconstruction, *Control of Cash Provided to South-Central Iraq*, Report No. 05-006 (Apr. 30, 2005).

66 *Id.*

67 *Id.*

68 *Id.*

69 *Id.*

violated the CPA's obligations to "ensure DFI funds were used in a transparent manner," according to the Special Inspector General's report.[70]

The Special Inspector General's report found that "proper cash accountability was not maintained, physical security was inadequate, fund agent records were not complete, and fund managers' responsibilities and liabilities were not properly assigned."[71] The report concluded that "the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner" and that "the CPA disbursed over $8.8 billion in DFI funds to the Iraqi ministries without assurance the monies were properly used or accounted for."[72]

According to the audit report, a large portion of the funds given to the Iraqi ministries were designated for payments of salaries, but the "CPA did not implement adequate controls to ensure DFI funds were properly used for salaries of Iraqi employees."[73] When transferring funds to Iraqi ministries, CPA relied on lists of employees and salaries that were prepared by Iraqi ministries and could not confirm that employees actually worked at the ministries or served useful functions. At one ministry audited, 8,206 guards were on the payroll, although only 602 guards could be validated.[74] The Special Inspector General concluded that "there was no assurance funds were not provided for ghost employees."[75]

Mr. Willis, the former CPA official, corroborated the findings of the Special Inspector General. According to Mr. Willis, the state-run Iraqi Airways, which had not been operational for a year, had 2,400 employees on the payroll, when the airline should have had a staff of 400 or fewer. Mr. Willis said that once the cash was turned over to the ministries, there were no CPA controls on or tracking of the funds: the transfer of cash was "all based on trust."[76] Mr. Willis concluded that in the absence of any accounting system, Iraqi officials skimmed funds as the

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70 Special Inspector General for Iraq Reconstruction, *Oversight of Funds Provided to Iraqi Ministries through the National Budget Process*, Report No. 05-004 (Jan. 30, 2005).

71 *Id.*

72 *Id.*

73 *Id.*

74 *Id.*

75 *Id.*

76 Interview of Frank Willis, Committee on Government Reform, Minority Staff (Jan. 27, 2005).

cash went through the system. In his view, there was "leakage of assets all over the place."[77]

IAMB audits of DFI funds, conducted by KPMG, identified similar problems. KPMG was "informed that the CPA mainly relied on the internal controls established at the Iraqi Ministries ... to ensure funds disbursed to Iraqi Ministries were utilized as budgeted."[78] However, as the Special Inspector General found, "these institutions were not yet functioning and should not have been relied upon to monitor the Iraqi ministries use of funds."[79]

In a response to the Special Inspector General's report, Ambassador Bremer argued that the report assumed that "western-style budgeting and accounting standards" could be implemented in the "midst of war." The Special Inspector General disputed these claims, explaining:

> We fully recognize that the CPA operated in a dangerous working environment under difficult conditions. However, the existing administration conditions should have underscored the need for controls over the disbursements to the Iraqi ministries. The CPA should have established controls and provided oversight over the financial management of the DFI funds precisely because there was no functioning Iraqi government, no experience within the Ministry of Finance in managing the national budget, no budget or personnel records, and the payroll systems were corrupted by cronyism and ad hoc fixes.[80]

In another example of questionable distributions for ministry expenses, the Special Inspector General found that "approximately $1.5 billion in cash allocations were made to Iraqi banks between January and April 2004 for ministry operating expenses, yet spending plans supported only approximately $498 million in operating expenses."[81] The Special Inspector General reported that "CPA OMB personnel were unable to provide supporting documentation or

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77 Testimony of Frank Willis, *An Oversight Hearing on Waste, Fraud and Abuse in U.S. Government Contracting in Iraq*, Senate Democratic Policy Committee (Feb. 14, 2005).

78 KPMG, *Development Fund for Iraq: Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004* at 3.2.1 (Oct. 14, 2004).

79 Special Inspector General for Iraq Reconstruction, *Oversight of Funds Provided to Iraqi Ministries through the National Budget Process*, Report No. 05-004 (Jan. 30, 2005).

80 *Id.*

81 *Id.*

explain significant differences between the spending plans, budget disbursements, and cash allocations."[82] These discrepancies left over $1 billion in allocations to Iraqi banks unsupported by ministry spending plans.

5. Irregularities in Disbursements to Provincial Governments

The Coalition Provisional Authority also provided funds from the DFI to help local provincial governments conduct their operations. According to KPMG, "[t]he BSA [Iraqi Board of Supreme Audit] reported that total disbursements for the Provincial Treasuries visited during the period amounted to approximately $1,000,000,000."[83]

However, the auditors found "no supporting documentation available at Provincial Treasuries for disbursements made by the CPA on behalf of Provincial Treasuries."[84] In addition, "[n]umerous disbursements to and from the Provincial Treasuries and their divisions were not recorded or incorrectly recorded by either party."[85]

IV. CONCLUSION

After the invasion of Iraq, the U.S.-run Coalition Provisional Authority took control of more than $22.4 billion in Iraqi resources and spent or disbursed $19.6 billion. While these Iraqi assets were under U.S. control, unprecedented sums were withdrawn in cash from the Federal Reserve and shipped to Iraq, where they were spent or disbursed by the CPA with virtually no financial controls. Partial audits of these expenditures have disclosed evidence of substantial waste, fraud, and abuse.

Because of the lack of oversight and accounting, the extent of wasteful and corrupt spending during the period of U.S. control is not known. Additional investigation will be needed to provide a complete accounting of what happened to the Iraqi funds and to identify those responsible for excessive and fraudulent expenditures.

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82 *Id.*

83 KPMG, *Development Fund for Iraq: Report of Factual Findings in connection with Disbursements for the period from 1 January 2004 to 28 June 2004*, 5.2.8 (Oct. 14, 2004).

84 *Id.*

85 *Id.*

Mr. WAXMAN. Thank you, Mr. Chairman.

What we found was an appalling level of incompetence, mismanagement, waste, fraud, and greed. As we will hear today from the Special Inspector General for Iraq Reconstruction, literally billions of dollars of Iraqi assets taken from the DFI cannot be accounted for.

The story of the DFI begins at the Federal Reserve Bank in New York, where the Iraqi assets were held on deposit. As the Federal Reserve documents show, cash withdrawals on a previously unimaginable scale were ordered by U.S. officials in Iraq. In total, nearly $12 billion in cash was withdrawn from the DFI account at the Federal Reserve, the largest cash withdrawals in history.

The administration transferred from New York to Baghdad more than $281 million individual currency notes on 484 pallets, weighing a total of 363 tons. This included more than 107 million $100 bills.

I'd like to show the committee a picture which is on our screen. These are what Federal Reserve officials called "cash packs." Each one contains 16,000 bills. One cash pack with $100 bills is worth $1.6 million. And the Federal Reserve shipped more than 19,000 of these cash packs to Iraq.

In late June, 2004, in the last week of its existence, the U.S.-run Coalition Provisional Authority ordered the urgent delivery of more than $4 billion, including the largest 1-day transfer in the history of the Federal Reserve, a single shipment of $2.4 billion in cash.

Well, so much cash arriving in Iraq, you might think that extensive precautions would be taken to account for the funds, but the exact opposite happened. U.S. officials used virtually no financial controls to safeguard the Iraqi funds. No certified public accounting firm was hired to monitor disbursements, and auditors found that U.S. officials could not account for billions of dollars.

One former CPA official told us that Iraq was awash in $100 bills. One contractor received a $2 million cash payment in a duffel bag. Other cash payments were made from the back of a pickup truck. And cash was stored in unguarded sacks in Iraqi ministry offices.

The records are so lacking that it is impossible to know the full extent of waste, fraud, and abuse that occurred during the period of U.S. control, but what we do know is alarming. The largest single recipient of DFI funds was Halliburton, the company vastly overcharged to import gasoline into Iraq and to provide other oil-related services. These overcharges, which exceed $200 million, were billed to the U.S. Corps of Engineers, but U.S. officials arranged for over 80 percent of them to be paid out of the DFI.

Here's the most incredible part. When the U.N. auditors charged with overseeing the DFI asked about the overcharges, U.S. officials concealed them. In fact, if it were not for my efforts to disclose these overcharges and those of Chairman Shays, U.N. auditors would still be mislead.

Another politically connected firm, Custer Battles, received over $11 million in Iraqi funds, including over $4 million in cash, but the company's overcharges were so blatant that it is now barred from receiving Federal contractors and is facing a False Claims Act lawsuit for fraudulent billing.

Over $600 million in Iraqi funds were given to military commanders and other U.S. officials to fund local reconstruction projects, yet here's what a partial audit of $120 million in expenditures disclosed: more than 80 percent of funds could not be properly accounted for, and over $7 million in cash was simply missing.

One of the biggest problems that we will hear about today is what happened when U.S. officials gave over $8 billion in cash to Iraqi ministries that lacked internal and financial controls. As an audit by the Special Inspector General found, we simply cannot account for billions of these dollars. In many instances, the records indicate that these funds may have been paid to ghost employees who never existed.

Today's hearing is the first in Congress on the DFI, but it should not be the last. We know a lot went wrong, but we do not know who is responsible, who squandered the money, and who should be held accountable. There is an urgent need for more investigation, and I hope this committee will play a major role.

Mr. Chairman, I look forward to the hearing and I thank all the witnesses for being here today.

Mr. SHAYS. I thank the gentleman.

[The prepared statement of Hon. Henry A. Waxman follows:]

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INDEPENDENT

Statement of
Rep. Henry A. Waxman, Ranking Minority Member
Committee on Government Reform
Before the Subcommittee on National Security, Emerging Threats, and International Relations
Hearing on the Development Fund for Iraq: U.S. Management of Iraq Oil Proceeds and Compliance with U.N. Security Council Resolution 1483

June 21, 2005

Today, the Subcommittee is holding a hearing on the Development Fund for Iraq. This is an important – and overdue – hearing. U.S. mismanagement of the DFI is one of the biggest untold stories of the war in Iraq.

After U.S. forces invaded Iraq in 2003, the U.N. Security Council created the DFI to hold Iraq's oil revenues and other assets. And the Security Council gave U.S. officials the authority to use the DFI for the benefit of the Iraqi people.

Since then, U.S. officials have spent or disbursed over $19 billion of Iraqi money in the DFI. Yet there has been virtually no congressional oversight – and little public understanding – of these enormous expenditures.

I want to begin my remarks by commending Chairman Shays for holding this hearing. Today's hearing is the first congressional hearing on the DFI and how U.S. officials managed – and mismanaged – the Iraqi assets in the fund. Chairman Shays has asked hard questions and approached today's hearing with an open mind and a spirit of bipartisanship.

The DFI is closely related to the Oil for Food Program. The DFI, which was run by the United States, is the successor to the Oil for Food Program, which was run by the United Nations. In fact, over $8 billion in the Oil for Food Program was transferred into the DFI by the U.N. Security Council.

Yet there has been a stark – and telling – contrast between Congress' approach to the Oil for Food Program and the DFI. Five separate congressional committees have been investigating U.N. mismanagement of the Oil for Food Program, and more than a dozen hearings have been

held. But before today, there was not a single hearing in Congress on U.S. mismanagement of the Development Fund for Iraq.

This neglect of the DFI has come at a steep cost to both congressional and public understanding of the actions of U.S. officials.

My staff has prepared a report that provides a comprehensive analysis of what is known about the DFI expenditures. The report is based on a review of over 14,000 pages of financial records subpoenaed from the Federal Reserve Bank; 15,000 pages of documents from the Defense Department; reports from multiple U.S. audit agencies; and interviews with international investigators, U.S. agency representatives, and Iraqi officials. I ask that this report be made part of the record.

What we found was an appalling level of incompetence, mismanagement, waste, fraud, and greed. As we will hear today from the Special Inspector General for Iraq Reconstruction, literally billions of dollars of Iraqi assets taken from the DFI cannot be accounted for.

The story of the DFI begins at the Federal Reserve Bank in New York, where the Iraqi assets were held on deposit. As the Federal Reserve documents show, cash withdrawals on a previously unimaginable scale were ordered by U.S. officials in Iraq.

In total, nearly $12 billion in cash was withdrawn from the DFI account at the Federal Reserve – the largest cash withdrawals in history. The Administration transferred from New York to Baghdad more than 281 million individual currency notes on 484 pallets weighing a total of 363 tons. This included more than 107 million $100 bills.

I'd like to show the Committee a picture. These are what Federal Reserve officials call "cashpaks." Each one contains 16,000 bills. One cashpak with $100 bills is worth $1.6 million. The Federal Reserve shipped more than 19,000 of these cashpaks to Iraq.

In late June 2004 – in the last week of its existence – the U.S.-run Coalition Provisional Authority ordered the urgent delivery of more than $4 billion, including the largest one-day transfer in the history of the Federal Reserve -- a single shipment of $2.4 billion in cash.

With so much cash arriving in Iraq, you might think that extensive precautions would be taken to account for the funds. But exactly the opposite happened: U.S. officials used virtually no financial controls to safeguard the Iraqi funds. No certified public accounting firm was hired to monitor disbursements, and auditors found that U.S. officials could not account for billions of dollars.

One former CPA official told us that Iraq was awash in $100 bills. One contractor received a $2 million cash payment in a duffel bag … other cash payments were made from the back of a pickup truck … and cash was stored in unguarded sacks in Iraqi ministry offices.

The records are so lacking that it's impossible to know the full extent of the waste, fraud, and abuse that occurred during the period of U.S. control. But what we do know is alarming.

The largest single recipient of DFI funds was Halliburton. The company vastly overcharged to import gasoline into Iraq and to provide other oil-related services. These overcharges – which exceed $200 million – were billed to U.S. Army Corps of Engineers. But U.S. officials arranged for over 80% of them to be paid out of the DFI.

And here's the most incredible part: When the U.N. auditors charged with overseeing the DFI asked about the overcharges, U.S. officials concealed them.

In fact, if it were not for my efforts to disclose these overcharges – and those of Chairman Shays – U.N. auditors would still be misled.

Another politically connected firm, Custer Battles, received over $11 million in Iraqi funds, including over $4 million in cash. But the company's overcharges were so blatant that it is now barred from receiving federal contracts and is facing a False Claims Act lawsuit for fraudulent billings.

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One of the biggest problems that we will hear about today is what happened when U.S. officials gave over $8 billion in cash to Iraqi ministries that lacked internal and financial controls. As an audit by the Special Inspector General found, we simply can't account for billions of these dollars. In many instances, the records indicate that these funds may have been paid to "ghost employees" who never existed.

Today's hearing is the first in Congress on the DFI, but it shouldn't be the last. We know a lot went wrong, but we don't know who is responsible, who squandered the money, and who should be held accountable. There is an urgent need for more investigation. And I hope this Committee will play a major role.

I look forward to today's hearing.

TOM DAVIS, VIRGINIA,
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INDEPENDENT

June 20, 2005

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

Dear Mr. Chairman:

I am writing to request that the Subcommittee issue a subpoena at tomorrow's hearing on the Development Fund for Iraq (DFI). Specifically, I ask that the Subcommittee order the production of all documents relating to the Defense Department's attempts to conceal Halliburton's overcharges in Iraq from the United Nations and Congress. The Subcommittee's repeated requests for this information have been ignored, and the Pentagon is now engaged in a pattern of blatant obstruction.

There have been more than a dozen congressional hearings on allegations of abuse in the Oil for Food program, which was run by the United Nations. Tomorrow's Subcommittee hearing will be the first to examine the DFI, the successor to the Oil for Food program that was controlled by U.S. officials. I commend you for holding this hearing and for your efforts to "follow the money" wherever it leads to ensure accountability.

Unfortunately, the Administration has obstructed inquiries into hundreds of millions of dollars in overcharges that Halliburton billed to the U.S. government and that U.S. officials charged to the DFI. On May 22, 2003, the U.N. Security Council passed Resolution 1483, which required the United States to spend DFI funds in a "transparent" manner for the benefit of the Iraqi people. Although the Defense Department used $1.6 billion in DFI funds to pay Halliburton under its oil reconstruction contract with the U.S. Army, the Administration has refused to provide the United Nations with copies of multiple Pentagon audits identifying overcharges under this contract. After months of repeated requests from the United Nations, the Pentagon did agree to deliver some of these audits, but they were so heavily redacted that the U.N. official in charge of monitoring the DFI concluded that "it was impossible to determine the extent of alleged overcharges."

The Administration also tried to obstruct Congress' efforts to investigate Halliburton's overcharges. After learning of the redactions to the Pentagon audits submitted to the United Nations, you and I made a joint request on October 5, 2004, for unredacted copies of these reports. Pentagon officials claimed for months that our request was being processed. When I obtained an unredacted version of one of the audits that revealed over $108 million in Halliburton overcharges, Pentagon officials disingenuously asserted we had never requested the unredacted audits. We finally received the complete audits five months after our initial request, and only after you had sent a second written request and your staff had intervened forcefully.

We now know that these audits, as updated by the Defense Contract Audit Agency, show more than $218 million in total overcharges by Halliburton, including more than $177 million in overcharges that were paid by the DFI. Yet every reference to every overcharge in every audit submitted to the United Nations was redacted. In total, references to overcharges and other questioned costs were blacked out more than 460 times.

In an effort to understand which Defense Department officials were responsible for approving these redactions and why they did so, we wrote to Secretary Rumsfeld on April 14, 2005, jointly requesting legal memoranda, correspondence, e-mails, and other documents relating to the redaction process. After getting no response, you sent a second letter, and our staffs followed-up repeatedly via e-mail, telephone, and in person. Yet more than two months later, the Department still has not provided a single document in response to these requests.

We did, however, receive a briefing last week that raised serious questions about the Department's conduct and the legality of its actions. At the briefing with Subcommittee staff, Pentagon officials confirmed that Halliburton requested extensive redactions in the audits and that Pentagon officials accepted all of Halliburton's suggested redactions without modification. Moreover, we were told that Halliburton's redactions were discussed extensively at "multiple meetings" within the Defense Department. Participants included officials from the Office of General Counsel, the Office of Deputy Secretary of Defense Wolfowitz, the Comptroller's Office, the Defense Support and Reconstruction Office, and the Army Corps of Engineers.

The ostensible rationale for accepting these redactions was that Defense Department officials were incapable of "second-guessing" Halliburton's assertion of what information within the audits was proprietary. Some officials at the Corps of Engineers urged the Department to conduct a "sanity check" of Halliburton's redactions. But the Department's lawyers determined that any disclosure of the overcharges would reflect unfavorably on Halliburton, impairing its ability to obtain future contracts.

We were also informed that Department officials were threatened if they considered disclosing any of the overcharges. According to those who attended the meetings, the General Counsel's office warned that any executive branch official who disclosed any part of the audits

— including the overcharges — without the express permission of Halliburton would face criminal penalties under the Trade Secrets Act.

The Defense Department's position appears indefensible. Multiple independent experts have told the Subcommittee that contractor overcharges are not "proprietary information" that can be legitimately withheld under any legal rationale. In effect, Defense Department officials acted as if they were working for Halliburton, not the federal government. They placed a higher priority on preserving Halliburton's future business prospects than on complying with the requirements of the U.N. Security Council resolution and protecting the interests of the taxpayer.

The actions of the Defense Department were seriously misguided and should be thoroughly investigated by the Subcommittee. In the face of the Department's continued obstruction, the Subcommittee's only alternative is to subpoena the records being withheld by the Department.

Concealing Halliburton's Overcharges from the United Nations

Under its no-bid Restore Iraqi Oil (RIO) contract with the U.S. Army Corps of Engineers, Halliburton subsidiary KBR charged approximately $2.5 billion for the importation of fuel, the preparation of war damage assessments, and the repair of oil facilities in Iraq.[1] All of the work under the contract was performed on a "cost-plus" basis, which meant that Halliburton received full reimbursement for its costs and additional fees of 2% to 7%.[2]

The Defense Department paid Halliburton with a mix of Iraqi and U.S. funds. Of the $2.5 billion Halliburton received, over $1.6 billion came from Iraqi oil proceeds deposited into the U.S.-controlled Development Fund for Iraq and $875 million came from U.S. Treasury.[3] The DFI expenditures were governed by U.N. Security Council Resolution 1483, which required the United States to use DFI funds "in a transparent manner to meet the humanitarian needs of the Iraqi people ... and for other purposes benefiting the people of Iraq."[4]

To ensure that the United States administered the DFI in compliance with this requirement, the Security Council created the International Advisory and Monitoring Board (IAMB) to oversee U.S. stewardship of the DFI. The IAMB includes members representing the

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

[2] *Id.*

[3] *Id.*

[4] United Nations Security Council Resolution 1483 (May 22, 2003) (emphasis added).

United Nations, the International Monetary Fund, the World Bank, and the Arab Fund for Social and Economic Development.[5] The IAMB was envisioned as the primary vehicle for guaranteeing the transparency of the DFI and for ensuring that DFI funds were used properly. According to U.N. Secretary General Kofi Annan, the IAMB was intended to act as the "eyes and ears of the international community."[6] When the United States assumed responsibility for these funds, it explicitly agreed to these terms.[7]

Beginning on March 17, 2004, IAMB officials repeatedly sought information from the United States about Halliburton's no-bid RIO contract.[8] On April 5, 2004, Jean-Pierre Halbwachs, the Chairman of the IAMB and the Assistant Secretary General and Controller of the United Nations, sent a formal request to Ambassador Bremer asking for "further information on all sole-sourced contracts paid for using DFI funds," including "contracts amounting to $1.4 billion [that] were awarded to Halliburton."[9] The IAMB Chairman also specifically requested copies of "a number of audits relating to these contracts" conducted by the U.S. government.[10]

Over the next several months, the Administration failed to respond to numerous additional requests for these audits.[11] In a September 8, 2004, statement, the international

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[5] *Id.*

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

[7] Coalition Provisional Authority, Memorandum No. 4: Contract and Grant Procedures Applicable to Vested and Seized Iraqi Property and the Development Fund for Iraq (Aug. 19, 2003) ("As steward for the Iraqi people, the CPA will manage and spend Iraqi Funds, which belong to the Iraqi people, for their benefit. ... [T]hey shall be managed in a transparent manner that fully comports with the CPA's obligations under international law, including Resolution 1483").

[8] International Advisory and Monitoring Board, *Minutes of Meeting* (Mar. 17–18, 2004) (noting that "some contracts using DFI funds were awarded to Halliburton without competitive bidding" and directing its certified public accounting firm, KPMG, "to pay special attention" to this issue).

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

[10] *Id.*

[11] *See, e.g.*, International Advisory and Monitoring Board, *Minutes of Meeting* (Apr. 22–23, 2004) (reporting that the IAMB "followed up with the CPA on its earlier request to access audits of sole-sourced contracts funded by the DFI, including those by the Defense Contract Audit Agency"); International Advisory and Monitoring Board, *Minutes of Meeting* (May 24–25, 2004) (reiterating "earlier requests by the Board to obtain audit reports regarding sole source

auditors explained that they still had "not received reports on audits undertaken by various U.S. agencies on sole-sourced contracts, despite repeated requests."[12] According to the statement, "The IAMB expressed its strong concern with these delays that hamper fulfillment of its mandate."[13]

The Administration finally provided the IAMB with "redacted copies of the DCAA audit reports on sole sourced contracts, at its meeting in October 2004."[14] However, every reference to every overcharge in every audit submitted to the IAMB was redacted. In total, references to overcharges and other questioned costs were blacked out at least 463 times.[15] Without any overcharge figures, the redacted audits were essentially useless to the international auditors charged with monitoring U.S. disbursements of DFI funds. After examining the redacted audits, Mr. Halbwachs, the chair of the IAMB, reported that "it was impossible to determine the extent of alleged overcharges because the figures had been redacted."[16]

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contracts, including those by the Defense Contract Audit Agency" and noting "difficulties" with CPA officials); International Advisory and Monitoring Board, *Statement by the International Advisory and Monitoring Board* (May 25, 2004) (stating that the IAMB "looks forward to the imminent receipt of the audits on sole-sourced contracts being conducted by U.S. government agencies"); International Advisory and Monitoring Board, *Statement by the International Advisory and Monitoring Board* (June 22, 2004) (stating that the "IAMB regrets, despite its repeated requests, the delay in receiving reports on audits undertaken by various agencies on sole-sourced contracts funded by the DFI").

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

[13] *Id.*

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

[15] Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5* (Audit Report No. 3311-2004K17900055) (Oct. 8, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 6* (Audit Report No. 3311-2004K21000028) (Sept. 16, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 7* (Audit Report No. 3311-2004K21000007) (Sept. 17, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 8* (Audit Report No. 3311-2004K21000008) (Aug. 31, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 9* (Audit Report No. 3311-2004K21000011) (Aug. 30, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 10* (Audit Report No. 3311-2004K21000012) (Aug. 31, 2004).

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

In addition to the audits described above, the Subcommittee has learned that the Defense Department is currently withholding in their entirety several additional, updated DCAA audits of Halliburton's overcharges. In February 2005, DCAA completed updated audits for five task orders under Halliburton's contract, all of which were funded through the DFI.[17] Yet the Defense Department has provided none of these updated audits to the United Nations, even in redacted form. In fact, it does not appear that the Defense Department ever informed international auditors of the existence of these audits. The Administration has provided no explanation for how withholding these updated audits from the IAMB complies with the transparency requirement set forth in U.N. Security Council Resolution 1483.

Concealing Halliburton's Overcharges from Congress

After concealing Halliburton's overcharges from the United Nations, the Pentagon unsuccessfully attempted to conceal them from Congress. On October 5, 2004, you and I wrote jointly to Secretary Rumsfeld requesting unredacted copies of the DCAA audits submitted to the United Nations.[18] Although Defense Department officials provided us with redacted copies, they repeatedly claimed that our request for unredacted copies was being processed. These delaying tactics persisted for months as our staff made 12 separate follow-up inquiries. In fact, when a member of your staff informed the Defense Department in February that a subpoena was being prepared, a Defense Department official replied that "issuing a subpoena will not get the material released any faster."[19]

During this period, I obtained an unredacted version of one of the DCAA audits, issued on October 8, 2004, showing that Pentagon auditors found overcharges of $108.4 million under

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[17] Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 5* (Audit Report No. 3311-2005K21000024) (Feb. 25, 2005); Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 7* (Audit Report No. 3311-2005K21000025) (Feb. 25, 2005); Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 8* (Audit Report No. 3311-2005K21000026) (Feb. 25, 2005); Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 9* (Audit Report No. 3311-2005K21000019) (Feb. 3, 2005); Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 10* (Audit Report No. 3311-2005K21000020) (Feb. 3, 2005).

[18] Letter from Reps. Christopher Shays and Henry A. Waxman to Defense Secretary Donald H. Rumsfeld (Oct. 5, 2004).

[19] Email from Staff, Office of the Secretary of Defense, Legislative Affairs, to Majority and Minority Staff, House Committee on Government Reform (Feb. 28, 2005).

Task Order 5, which was valued at $875 million.[20] The DCAA auditors found overcharges in nearly every area, including labor, material, subcontracts, and overhead. After I disclosed this information and requested the remaining audits, Defense Department officials argued for the first time that you and I had never requested the unredacted audits, claiming that "[w]e have all been waiting for a request in writing from the Chairman."[21] As a result, you sent a second letter to Defense Secretary Rumsfeld on March 15, 2005, requesting the audits "once again."[22] As you correctly noted in that letter, the Committee had been "repeatedly assured the unredacted documents were being prepared for transmittal."[23]

Finally, after a delay of five months and vigorous intervention by your staff, the Defense Department provided the unredacted copies of the DCAA audits that were provided to the United Nations. The Defense Department also turned over more recent, updated audits, as well as audits relating to task orders funded with U.S. appropriated funds.[24] The most recent versions of these audits identify questioned and unsupported costs of $279,126,961.[25] Of this amount, auditors

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[20] Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5* (Audit Report No. 3311-2004K17900055) (Oct. 8, 2004).

[21] Email from Staff, Office of the Secretary of Defense, Legislative Affairs, to Majority Staff, House Committee on Government Reform (Mar. 14, 2005). *See also* Letter from Reps. Henry A. Waxman and John D. Dingell to President George W. Bush (Mar. 14, 2005).

[22] Letter from Rep. Christopher Shays to Defense Secretary Donald H. Rumsfeld (Mar. 15, 2005).

[23] *Id.*

[24] In addition to audits for Task Orders 5 through 10, the Subcommittee has now obtained audits for Task Orders 1 through 4. *See* Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil, Task Order No. 1* (Audit Report No. 3311-2004K17900011) (Mar. 19, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil, Task Order No. 2* (Audit Report No. 3311-2004K17900009) (Apr. 9, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil, Task Order No. 3* (Audit Report No. 3311-2004K17900056) (Oct. 2, 2004); Defense Contract Audit Agency, *Report on Audit of the Additional Funding Proposal for RIO I Task Order No. 04* (Audit Report No. 3311-2004K17900086) (Sept. 3, 2004). Last week, the Subcommittee learned that auditors issued another updated audit for Task Order 5 on April 16, 2005. Although the Subcommittee has not yet received this audit, the auditors reported that they have identified $84,446,016 in questioned costs.

[25] Government auditors at the Defense Contract Audit Agency (DCAA) draw a distinction between "questioned costs" and "unsupported costs." Questioned costs are billings that the auditors have concluded are excessive and should not be paid by the government. Unsupported costs are billings that the contractor has submitted for payment, but have not been

identified $218,793,196 in "questioned costs," which is the term DCAA uses for overcharges. They indicate that most of Halliburton's overcharges — $171 million — involved its fuel importation work.[26] The auditors also identified $60,333,765 as unsupported costs. Table A below sets forth Halliburton's questioned costs (overcharges) and unsupported costs identified by Defense Department auditors under the Iraqi oil contract.

TABLE A:
QUESTIONED AND UNSUPPORTED COSTS UNDER HALLIBURTON'S RESTORE IRAQI OIL (RIO) CONTRACT

TASK ORDER	QUESTIONED COSTS (OVERCHARGES)	UNSUPPORTED COSTS	COMBINED
1	904,146	0	904,146
2	199,804	0	199,804
3	12,239,343	41,456,016	53,695,359
4	12,483,195	1,216,216	13,699,411
5	84,446,016	0	84,446,016
6	16,552,846	17,661,533	34,214,379
7	35,681,321	0	35,681,321
8	22,780,683	0	22,780,683
9	19,902,697	0	19,902,697
10	13,603,145	0	13,603,145
TOTALS	**$218,793,196**	**$60,333,765**	**$279,126,961**

Of the $279,126,961 in total questioned and unsupported costs identified by the Defense Department auditors under Halliburton's contract, $195,174,068 were funded through the DFI. These included $177,512,535 in questioned costs, and $17,661,533 in unsupported costs.[27]

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able to document adequately. Questioned costs are equivalent to overcharges; unsupported costs require further review and documentation before they are classified as legitimate or questioned.

[26] Defense Contract Audit Agency, *Briefing Slides: DCAA Contract Audit Support for Iraq Reconstruction* (Apr. 15, 2005) (reporting that Halliburton "failed to support the reasonableness of prices paid for fuel purchased from a Kuwaiti supplier ($139 million)" and "inappropriately adjusted fixed prices for fuel purchased from a Turkish supplier ($32 million)").

[27] U.S. Army Corps of Engineers, *Frequently Asked Questions: Engineer Support to Operation Iraqi Freedom* (Oct. 7, 2004) (online at http://www.hq.usace.army.mil/CEPA/Iraq/March03-table.htm) (calculated using amounts noted under each task order as funded through the DFI, seized Iraqi assets, and U.S. appropriated funds).

Table B below sets forth the amounts of Halliburton's overcharges billed to both U.S. taxpayers and the Iraqi people under the DFI.

TABLE B:
HALLIBURTON'S OVERCHARGES BILLED TO THE DEVELOPMENT FUND FOR IRAQ (DFI)

TASK ORDER	QUESTIONED COSTS (OVERCHARGES)	BILLED TO U.S. TAXPAYERS	BILLED TO THE DFI
1	904,146	904,146	
2	199,804	199,804	
3	12,239,343	12,239,343	
4	12,483,195	12,483,195	
5	*84,446,016	6,889,668	68,991,843
6	16,552,846		16,552,846
7	35,681,321		35,681,321
8	22,780,683		22,780,683
9	19,902,697		19,902,697
10	13,603,145		13,603,145
TOTALS	**$218,793,196**	**$32,716,156**	**$177,512,535**

* Overcharges under Task Order 5 are greater than the sum of overcharges to U.S. and DFI funds because the Defense Department also used $8,564,504 in Iraqi seized assets to pay Halliburton's overcharges under this task order.

Many of the audits reported as their top finding under the executive summaries that Halliburton's proposals were "not acceptable for negotiation of a fair and reasonable price."[28] DCAA found that Halliburton's cost and pricing submissions were "not adequate" because they were not prepared "in accordance with applicable Cost Accounting Standards and appropriate provisions of FAR," the Federal Acquisition Regulation; because "proposed" costs "exceed recorded costs"; and because Halliburton's proposals "did not contain data to support the reasonableness of the negotiated purchase orders."[29]

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[28] *See, e.g., Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 8, supra* note 15, at 2.

[29] *See, e.g., Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 9, supra* note 15, at 4, 2, and 1.

The Redactions

In addition to obtaining the unredacted audits, the Subcommittee also discovered that the redactions were made at Halliburton's request. According to a letter Halliburton sent to the U.S. Army Corps of Engineers on September 28, 2004, Halliburton officials requested the redaction of not just proprietary business information, but all portions of the audits that they "believe are factually incorrect or misleading."[30]

Halliburton's extensive involvement with the redactions was confirmed at a briefing last week with Subcommittee staff. At the briefing, Defense Department officials confirmed that all of the redactions in the audits had been sought by Halliburton. They also stated that every redaction requested by Halliburton had been accepted without modification.[31]

We learned at the briefing that Halliburton's redactions were discussed extensively at "multiple meetings" within the Defense Department. Participating were numerous officials from the Office of General Counsel, staff from the Office of Deputy Secretary of Defense Paul Wolfowitz, Deputy Comptroller and Chief Financial Officer David Norquist, Deputy Director Joseph Benkert of the Defense Reconstruction Support Office, and several officials from the U.S. Army Corps of Engineers.[32]

We were told at the briefing that officials from the General Counsel's office instructed other Defense Department offices that Halliburton — and not the Defense Department — had ultimate authority to determine what information could be considered proprietary business information. In addition, the General Counsel's office advised that regardless of whether information was proprietary, Halliburton could withhold every word of these government audits, and it was merely due to Halliburton's "good graces" that anything was released to the United Nations at all.[33]

The stated rationale for this position was that Defense Department officials were incapable of "second-guessing" Halliburton's assertion of what information within the audits was proprietary. At the briefing, we were told that officials at the Corps of Engineers recommended that the Deparment conduct a "sanity check" of Halliburton's redactions. But this

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

[31] Meeting between Colonel Emmett DuBose, Deputy Commander of the U.S. Army Corps of Engineers, J. Joseph Tyler, Chief of the Program Management Division of the Army Corps of Engineers, and Majority and Minority Staff, Subcommittee on National Security, Emerging Threats and International Relations (June 15, 2005).

[32] *Id.*

[33] *Id.*

advice was rejected. Instead, the Department's attorneys determined that any disclosure of the overcharges would reflect unfavorably on Halliburton, thereby causing the company competitive harm.[34]

We were also informed at the briefing that the General Counsel's office warned that any Defense Department official who disclosed any part of the audits without the express permission of Halliburton would face criminal penalties under the Trade Secrets Act.[35]

As a legal matter, the position of the Department is highly dubious. According to national experts who testified before the Subcommittee, conclusions by government auditors about contractor overcharges are not proprietary information that can be withheld from the public. For example, J. William Leonard, the Director of the Information Security Oversight Office of the National Archives and Records Administration, testified that he has "never encountered" a case in which the government has withheld as proprietary business information the actual amount a company overcharged the government, as determined by government auditors.[36] Mr. Leonard also said that he "would be hard pressed to readily come up with a rationale" for such a withholding.[37] Harold C. Relyea of the nonpartisan Congressional Research Service agreed, stating: "It's hardly proprietary information."[38]

Similarly, Thomas M. Susman, an attorney and regulatory expert who examined Halliburton's redactions in detail, explained that a contractor may not redact audit information with which it simply disagrees. According to Mr. Susman, Halliburton "proposed redacting

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[34] *Id.*

[35] *Id.*

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

[37] *Id.* Indeed, the Pentagon itself previously treated Halliburton's overcharges under this contract as public information. At a December 11, 2003, press conference, DCAA officials publicly announced their preliminary findings of a $61 million overcharge by Halliburton for the gasoline imported from Kuwait. *See* U.S. Department of Defense, *News Briefing* (Dec. 11, 2003).

[38] *Id.* Both Mr. Leonard and Mr. Relyea also agreed that it would be improper for an agency to abdicate the responsibility to make its own assessment on the propriety of such redactions. Mr. Relyea characterized an agency's uncritical acceptance of a company's redactions as "a terrible abrogation of responsibility."

anything that could be embarrassing to the company plus anything it disagreed with."[39] He added, "they apparently felt they could get away with this."[40]

The Ongoing Cover-Up

It now appears that Administration officials are actively obstructing Congress' investigation into the withholding of Halliburton's overcharges. After discovering the size of Halliburton's overcharges concealed from the United Nations, the Subcommittee began an investigation to determine who at the Defense Department was involved in this effort. On April 14, 2005, we sent a joint letter to Secretary Rumsfeld asking for the identity of officials who played a role in this process.[41] We also requested correspondence between the Defense Department and Halliburton, as well as internal Pentagon documents that would shed light on how these decisions were made. We asked for these documents by May 27, 2005, so they could be used at the Subcommittee hearing tomorrow.

After receiving no response, you sent a second letter on May 23, 2005.[42] This letter repeated the earlier request and noted again the due date of May 27, 2005, for the production of documents. Both of our staffs also made repeated efforts to obtain these documents, without success. My staff counted at least nine specific e-mail requests, although there were many more requests by telephone and in person.[43] Again, we received no information in response from the Department.

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[39] *Now You See It: An Audit of KBR*, New York Times (Mar. 20, 2005).

[40] *Id.*

[41] Letter from Reps. Christopher Shays and Henry A. Waxman, Ranking Minority Member, Committee on Government Reform, to Defense Secretary Donald H. Rumsfeld (Apr. 14, 2005).

[42] Letter from Rep. Christopher Shays to Defense Secretary Donald H. Rumsfeld (May 23, 2005).

[43] *See, e.g.*, E-mail from Minority Staff, Committee on Government Reform, to Office of the Secretary of Defense, Legislative Affairs (May 18, 2005); E-mail from Majority Staff, Committee on Government Reform, to U.S. Army, Legislative Affairs (May 18, 2005); E-mail from Minority Staff, Committee on Government Reform, to U.S. Army, Legislative Affairs (May 19, 2005); E-mail from Minority Staff, Committee on Government Reform, to U.S. Army, Legislative Affairs (May 20, 2005); E-mail from Minority Staff, Committee on Government Reform, to Office of the Secretary of Defense, Legislative Affairs (May 27, 2005); E-mail from Majority Staff, Committee on Government Reform, to Office of the Secretary of Defense, Legislative Affairs (June 1, 2005); E-mail from Majority Staff, Committee on Government Reform, to Office of the Secretary of Defense, Legislative Affairs (June 9, 2005); E-mail from Minority Staff, Committee on Government Reform, to U.S. Army, Legislative Affairs (June 9,

By anyone's definition, the Subcommittee has been patient with the Department. Yet today, more than two months after our written request, there is still no indication that the Department is taking significant action to produce the information we requested. With this background alone, the Department's record of dissembling and delay is a sufficient basis for a subpoena.

Conclusion

The position of the Defense Department in this matter is hard to justify. Officials appear to have inverted the proper roles of government and contractor, giving Halliburton unprecedented authority to withhold key parts of Defense Department audits. Moreover, the Department appears not to comprehend — or not to care — that a U.N. Security Council resolution requires the United States to disclose Halliburton's overcharges to the United Nations.

I understand that your policy as Chairman of the Subcommittee has always been to try to obtain information from the Administration through letter requests. Indeed, when considering a similar motion to subpoena the Defense Department at our October 5, 2004, hearing, you stated that "my inclination is always to write a letter first."[44] In this case, however, we have sent multiple letters, our staffs have made more than a dozen follow-up requests, and the Department is engaged in an established pattern of obstruction.

For these reasons, the Subcommittee should issue a subpoena tomorrow compelling the production of all documents relating to the Defense Department's attempts to conceal Halliburton's overcharges from the United Nations and Congress.

Sincerely,

Henry A. Waxman
Ranking Minority Member

2005); E-mail from Minority Staff, Committee on Government Reform, to Office of the Secretary of Defense, Legislative Affairs (June 9, 2005).

[44] Subcommittee on National Security, Emerging Threats and International Relations, *Hearings on "The U.N. Oil-for-Food Program: Cash Cow Meets Paper Tiger"* (Oct. 5, 2005).

TOM DAVIS, VIRGINIA,
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April 11, 2005

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

Dear Mr. Chairman:

Last month, I sent letters to you and President Bush about oil reconstruction efforts in Iraq. These letters disclosed (1) that government auditors had found $108 million in fuel-related overcharges by Halliburton and (2) that although Halliburton was paid in significant part from Iraqi oil proceeds in the Development Fund for Iraq, the Administration had concealed the overcharges from auditors at the International Advisory and Monitoring Board (IAMB) in violation of U.N. Security Council Resolution 1483.

Due to your efforts, the Subcommittee has now obtained additional audits of Halliburton's Iraqi oil reconstruction work. These audits, conducted by the Defense Contract Audit Agency (DCAA), reveal that both the amount of Halliburton's overcharges and the extent of the information withheld are much greater than previously known.

As part of my March 14, 2005, letter to President Bush, which I sent with Rep. John Dingell, I released a DCAA audit of one of Halliburton's ten task orders under its no-bid Restore Iraqi Oil contract. This audit showed that the Pentagon auditors identified overcharges and questioned costs of $108.4 million under Task Order 5, one of several task orders for the importation of fuel into Iraq.

The new audits obtained by the Subcommittee show that the amounts of overcharges are actually far higher. The Subcommittee has now obtained DCAA audits of Task Orders 5 through 10. In these reports, DCAA auditors identify overcharges and question costs of $212.3 million, doubling the total amount of known overcharges under Halliburton's Iraq oil contract. In one case, the overcharges identified by DCAA exceeded 47% of the total value of the task order.

In my March 15, 2005, letter to you, I provided evidence that Administration officials — acting at Halliburton's request — intentionally withheld information about the overcharges associated with Task Order 5 from the IAMB, the international auditors charged by the United Nations with monitoring the expenditures from the Development Fund for Iraq (DFI). The new audits obtained by the Subcommittee reveal extensive additional information that has been withheld by the Administration from the IAMB. My review shows that references to overcharges and other questioned costs were blacked out over 460 times in the versions of audits sent to the IAMB. Indeed, every reference to every overcharge in every audit submitted to the IAMB was redacted. In addition, at least five updated DCAA audits were withheld in their entirety from the IAMB.

The new DCAA audits add to the mounting evidence of waste, fraud, and abuse involving the DFI. According to recent findings by the Special Inspector General for Iraqi Reconstruction, U.S. officials failed to properly account for nearly $9 billion in Iraqi funds in the DFI, violating the terms of U.N. Security Council Resolution 1483.

With the exception of your efforts, however, congressional oversight of the expenditure of Iraqi oil proceeds has been marred by a double standard. There have been 11 congressional hearings to date on the U.N. oversight of the Oil for Food program, but no hearings on whether the United States itself mismanaged the DFI, the successor to the Oil for Food program. The result may be politically convenient for the White House. News coverage of the problems in the U.N.-run Oil for Food program has outnumbered coverage of the problems in the U.S.-run Development Fund for Iraq roughly 17 to 1. But the deliberate neglect of the DFI has come at a steep cost to congressional and public understanding of the actions of U.S. officials — and to Congress' reputation internationally.

I commend you for the steps you have taken to oversee the DFI, including the efforts by you and your staff to obtain the DCAA audits detailing Halliburton's extraordinary overcharges. And I urge you to take the next step of scheduling Subcommittee hearings to examine U.S. mismanagement of the DFI and the Administration's failure to comply with the terms of Resolution 1483.

Background

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

transparent manner to meet the humanitarian needs of the Iraqi people ... and for other purposes benefiting the people of Iraq."[1]

To ensure that the United States administered the DFI in compliance with this requirement, Resolution 1483 also created the International Advisory and Monitoring Board (IAMB) to oversee U.S. stewardship of the DFI. The IAMB includes members representing the United Nations, the International Monetary Fund, the World Bank, and the Arab Fund for Social and Economic Development.[2]

The IAMB was envisioned as the primary vehicle for guaranteeing the transparency of the DFI and for ensuring that DFI funds are used properly. According to U.N. Secretary General Kofi Annan, the IAMB was intended to act as the "eyes and ears of the international community."[3] When the United States assumed responsibility for these funds, it explicitly agreed to these terms.[4]

During CPA's administration of the DFI, a total of $20.6 billion was deposited into the DFI account.[5] By June 28, 2004, approximately $19.7 billion of this total had been committed for reconstruction contracts and other purposes.[6]

The single largest private recipient of Iraqi oil proceeds under the DFI was Halliburton. Under the no-bid Restore Iraqi Oil (RIO) contract with the U.S. Army Corps of Engineers, a Halliburton subsidiary, KBR, charged approximately $2.5 billion for the importation of fuel for

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[1] United Nations Security Council Resolution 1483 (May 22, 2003) (emphasis added).

[2] *Id.*

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

[4] Coalition Provisional Authority, Memorandum No. 4: Contract and Grant Procedures Applicable to Vested and Seized Iraqi Property and the Development Fund for Iraq (Aug. 19, 2003) ("As steward for the Iraqi people, the CPA will manage and spend Iraqi Funds, which belong to the Iraqi people, for their benefit .... [T]hey shall be managed in a transparent manner that fully comports with the CPA's obligations under international law, including Resolution 1483").

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

[6] *Id.*

the Iraqi people, the preparation of damage assessments, and the repair of oil facilities.[7] There were two sources of funding for this contract: approximately $875 million came from U.S. taxpayer funds and $1.64 billion came from Iraqi oil proceeds and other Iraqi assets in the DFI.[8]

The Defense Department issued ten different task orders to Halliburton under the RIO contract. Task Orders 1, 2, 3, 4, and 6 related to various oil infrastructure projects, while Task Orders 5, 7, 8, 9, and 10 involved the importation of fuel from Kuwait, Turkey, and Jordan. All of the work under each task order was performed on a "cost-plus" basis, which meant that Halliburton received full reimbursement for its costs and additional fees of 2% to 7%.[9]

Beginning on March 17, 2004, IAMB officials repeatedly sought information from the United States about Halliburton's no-bid RIO contract.[10] On April 5, 2004, Jean-Pierre Halbwachs, the Chairman of the IAMB and the Assistant Secretary General and Controller of the United Nations, sent a formal request to Ambassador Bremer asking for "further information on all sole-sourced contracts paid for using DFI funds," including "contracts amounting to $1.4 billion [that] were awarded to Halliburton."[11] The IAMB Chairman also specifically requested copies of "a number of audits relating to these contracts" conducted by the U.S. government.[12]

Over the next several months, the Administration failed to respond to numerous additional requests for these audits.[13] In a September 8, 2004, statement, the international

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

[8] *Id.*

[9] *Id.*

[10] International Advisory and Monitoring Board, *Minutes of Meeting* (Mar. 17–18, 2004) (noting that "some contracts using DFI funds were awarded to Halliburton without competitive bidding" and directing its certified public accounting firm, KPMG, "to pay special attention" to this issue).

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

[12] *Id.*

[13] *See, e.g.*, International Advisory and Monitoring Board, *Minutes of Meeting* (Apr. 22–23, 2004) (reporting that the IAMB "followed up with the CPA on its earlier request to access audits of sole-sourced contracts funded by the DFI, including those by the Defense Contract Audit Agency"); International Advisory and Monitoring Board, *Minutes of Meeting* (May 24–25, 2004) (reiterating "earlier requests by the Board to obtain audit reports regarding sole source contracts, including those by the Defense Contract Audit Agency" and noting "difficulties" with

auditors explained that they still had "not received reports on audits undertaken by various U.S. agencies on sole-sourced contracts, despite repeated requests."[14] According to the statement, "The IAMB expressed its strong concern with these delays that hamper fulfillment of its mandate."[15]

The Administration finally provided the IAMB with "redacted copies of the DCAA audit reports on sole sourced contracts, at its meeting in October 2004."[16] These included DCAA audits of Task Orders 5 through 10 that were issued in August, September, and October of 2004.[17]

The DCAA Audits

On October 5, 2004, you and I wrote jointly to Secretary Rumsfeld requesting unredacted copies of DCAA audits for Task Orders 5 through 10.[18] Although Defense Department officials

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CPA officials); International Advisory and Monitoring Board, *Statement by the International Advisory and Monitoring Board* (May 25, 2004) (stating that the IAMB "looks forward to the imminent receipt of the audits on sole-sourced contracts being conducted by U.S. government agencies"); International Advisory and Monitoring Board, *Statement by the International Advisory and Monitoring Board* (June 22, 2004) (stating that the "IAMB regrets, despite its repeated requests, the delay in receiving reports on audits undertaken by various agencies on sole-sourced contracts funded by the DFI").

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

[15] *Id.*

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

[17] Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5* (Audit Report No. 3311-2004K17900055) (Oct. 8, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 6* (Audit Report No. 3311-2004K21000028) (Sept. 16, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 7* (Audit Report No. 3311-2004K21000007) (Sept. 17, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 8* (Audit Report No. 3311-2004K21000008) (Aug. 31, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 9* (Audit Report No. 3311-2004K21000011) (Aug. 30, 2004); Defense Contract Audit Agency, *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 10* (Audit Report No. 3311-2004K21000012) (Aug. 31, 2004).

[18] Letter from Reps. Christopher Shays and Henry A. Waxman to Defense Secretary Donald H. Rumsfeld (Oct. 5, 2004).

provided us with copies of the redacted audits sent to the IAMB, they repeatedly claimed that our request for unredacted copies was being processed. These delaying tactics persisted for months as our staff made 12 separate followup inquiries. In fact, when a member of your staff informed the Defense Department in February that a subpoena was being prepared, a Defense Department official replied that "issuing a subpoena will not get the material released any faster."[19]

Last month, I obtained an unredacted version of DCAA's audit of Task Order 5. This audit, issued on October 8, 2004, showed that Pentagon auditors found overcharges and questioned costs of $108.4 million under Task Order 5, which was valued at $875 million.[20] The DCAA auditors found overcharges in nearly every area, including labor, material, subcontracts, and overhead. On March 14, 2005, Rep. John Dingell and I wrote to President Bush asking how he planned to recover these overcharges and return them to the U.S. taxpayer and Iraqi people.[21]

After Rep. Dingell and I wrote to the President, Defense Department officials argued for the first time that you and I had never requested the unredacted audits, claiming that "[w]e have all been waiting for a request in writing from the Chairman."[22] As a result, you sent a second letter to Defense Secretary Rumsfeld on March 15, 2005, requesting the audits "once again."[23] As you correctly noted in that letter, the Committee had been "repeatedly assured the unredacted documents were being prepared for transmittal."[24]

Finally, after a delay of five months, the Defense Department has now turned over full and unredacted DCAA audits for Task Orders 5 through 10. In total, these audits identified overcharges and questioned costs of $212.3 million, doubling the total amount of known Halliburton overcharges under the Iraq oil contract.

Specifically, the Committee has now obtained 11 DCAA audits detailing overcharges under Halliburton's Iraqi oil contract. These include ten audits of Task Orders 5, 7, 8, 9, and 10.

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[19] Email from Staff, Office of the Secretary of Defense, Legislative Affairs, to Majority and Minority Staff, House Committee on Government Reform (Feb. 28, 2005).

[20] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5, supra* note 17, at 1.

[21] Letter from Reps. Henry A. Waxman and John D. Dingell to President George W. Bush (Mar. 14, 2005).

[22] Email from Staff, Office of the Secretary of Defense, Legislative Affairs, to Majority Staff, House Committee on Government Reform (Mar. 14, 2005).

[23] Letter from Rep. Christopher Shays to Defense Secretary Donald H. Rumsfeld (Mar. 15, 2005).

[24] *Id.*

DCAA conducted a first round of five audits in August, September, and October of 2004.[25] It conducted a second round of five updated audits in February of 2005.[26] These two rounds of audits had some differences in the amounts Halliburton proposed for reimbursement, as well as the amounts questioned by DCAA.[27] The Committee also obtained one DCAA audit detailing overcharges under Task Order 6, which did not involve fuel importation.[28]

DCAA's most recent conclusions regarding overcharges under Task Orders 5 though 10 are set forth in Table A (below).

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[25] *See supra* note 17.

[26] Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 5* (Audit Report No. 3311-2005K21000024) (Feb. 25, 2005); Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 7* (Audit Report No. 3311-2005K21000025) (Feb. 25, 2005); Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 8* (Audit Report No. 3311-2005K21000026) (Feb. 25, 2005); Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 9* (Audit Report No. 3311-2005K21000019) (Feb. 3, 2005); Defense Contract Audit Agency, *Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 10* (Audit Report No. 3311-2005K21000020) (Feb. 3, 2005).

[27] The audits indicate increases in some proposed costs and decreases in others. For example, the October 8, 2004, audit of Task Order 5 reviewed proposed costs of $875.3 million, while the February 25, 2005, audit of Task Order 5 reviewed proposed costs of $887.3 million. In contrast, the August 30, 2004, audit of Task Order 9 reviewed proposed costs of $64.8 million, while the February 3, 2005, audit of Task Order 9 reviewed proposed costs of $57.2 million. The audits also document increases in some overcharges and decreases in others. For example, the August 31, 2004, audit of Task Order 8 questioned costs of $21.9 million, while the February 25, 2005, audit of Task Order 8 questioned costs of $22.8 million. In contrast, the October 8, 2004, audit of Task Order 5 questioned costs of $108.4 million, while the February 25, 2005, audit of Task Order 5 questioned costs of $86.1 million.

[28] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 6, supra* note 17.

TABLE A: Overcharges Identified and Costs Questioned under Halliburton's Iraq Oil Contract

Task Order	Task Order Value	Overcharges and Questioned Costs	Percentage of Task Order Value
5	$887.3 million	$86.1 million	9.7%
6	$212.1 million	$34.2 million	16.1%
7	$324.9 million	$35.7 million	11.0%
8	$179.9 million	$22.8 million	12.7%
9	$57.2 million	$19.9 million	34.8%
10	$28.7 million	$13.6 million	47.4%
Total	**$1.69 billion**	**$212.3 million**	**12.6%**

According to these audits, most of Halliburton's overcharges and questioned costs — $174 million — involved its fuel importation work. In particular, unreasonable fuel costs from Kuwait accounted for $142 million, and improper retroactive payment increases to Turkish subcontractors accounted for $32 million.

DCAA auditors found unreasonable costs for Kuwaiti fuel under all of Halliburton's fuel importation task orders. The auditors criticized Halliburton for failing to negotiate better pricing for the fuel and transportation costs, concluding that Halliburton failed to provide "adequate documentation to demonstrate the reasonableness of the Kuwait fuel prices over the life of the purchase orders."[29]

The auditors also repeatedly criticized Halliburton for making unnecessary retroactive payments to its Turkish fuel subcontractors. DCAA noted that Halliburton had negotiated "fixed-unit-rate" and "firm-fixed-price" subcontracts with various Turkish subcontractors to import fuel into Iraq. During the term of these subcontracts, the market price of the fuel increased. DCAA reported that the Turkish companies asked Halliburton "to increase the unit price of the fuel to compensate for losses due to market increases."[30] According to DCAA,

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[29] *See, e.g., Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 5, supra* note 26, at 2.

[30] *See, e.g., Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 7, supra* note 26, at 2.

Halliburton "agreed to pay the higher prices retroactively."[31] DCAA concluded: "We do not believe it was appropriate to retroactively adjust the fuel unit prices of KBR's fixed-unit-rate and firm-fixed-price subcontracts when there are no provisions in the subcontracts to do so."[32]

All the DCAA audits — from both the first and second rounds of examination — reported as their first findings under the executive summaries that Halliburton's proposals were "not acceptable for negotiation of a fair and reasonable price."[33] DCAA found that Halliburton's cost and pricing submissions were "not adequate" because they were not prepared "in accordance with applicable Cost Accounting Standards and appropriate provisions of FAR," the Federal Acquisition Regulation, because "proposed" costs "exceed recorded costs," and because Halliburton's proposals "did not contain data to support the reasonableness of the negotiated purchase orders."[34]

The $212.3 million in overcharges identified by DCAA is likely to increase. DCAA did not evaluate the reasonableness of Halliburton's base and award fees, which are calculated as 2% to 7% of the company's underlying costs. Since DCAA identified overcharges in Halliburton's costs, its fees are likely to be overstated also. In addition, the Subcommittee has not received any audits of Task Orders 1 through 4, which have a total value of approximately $800 million.[35] Any overcharges related to these task orders would further increase the total.

Information Withheld from the United Nations

In my March 15, 2005, letter to you, I compared the redacted and unredacted versions of DCAA's audit of Task Order 5. This comparison showed that the Administration had concealed references to $108 million in Halliburton's overcharges, as well as key auditor findings, from the IAMB.

Now that the Subcommittee has obtained the unredacted audits for Task Orders 5 through 10, a more thorough analysis of the information withheld from the IAMB is possible. This review reveals that the amount of information concealed from the international auditors is

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[31] *Id.*

[32] *Id.*

[33] *See, e.g., Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 8, supra* note 26, at 2.

[34] *See, e.g., Report on Audit of Revised Proposal for Restore Iraqi Oil Delivery Order No. 9, supra* note 26, at 4, 2, and 1.

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

significantly greater than previously known. Indeed, every reference to every overcharge in every audit submitted to the IAMB was redacted. In total, references to overcharges and other questioned costs were blacked out at least 463 times by Halliburton and U.S. officials.

Examples of overcharges and other questioned costs that were redacted include the following:

- In DCAA's audit of Task Order 5, $62 million in "unreasonable costs" related to fuel imported from Kuwait.[36]
- In DCAA's audit of Task Order 6, $17.6 million in "[u]nsupported costs" due to Halliburton's "failure to perform adequate costs or price analysis as required by FAR [Federal Acquisition Regulation] 15.408."[37]
- In DCAA's audit of Task Order 7, $4.9 million in costs DCAA questioned because Halliburton "failed to use the correct purchase order change orders for the Turkey purchase orders."[38]
- In DCAA's audit of Task Order 8, $2 million in proposed LPG cancellation fees that Halliburton "has not been able to identify or support."[39]
- In DCAA's audit of Task Order 9, $23 million in "questioned ... material and subcontract costs primarily due to KBR's failure to demonstrate reasonable pricing for the Kuwaiti fuel and transportation costs."[40]
- In DCAA's audit of Task Order 10, $10 million for kerosene purchased and delivered after the Army contracting officer directed Halliburton "to stop all kerosene imports from Kuwait."[41]

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[36] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5*, *supra* note 17, at 10.

[37] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 6*, *supra* note 17, at 3.

[38] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 7*, *supra* note 17, at 2.

[39] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 8*, *supra* note 17, at 2.

[40] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 9*, *supra* note 17, at 8.

Without any overcharge figures, the redacted audits were essentially useless to the international auditors charged with monitoring U.S. disbursements of DFI funds. After examining the redacted audits, Mr. Halbwachs, the chair of the IAMB, reported that "it was impossible to determine the extent of alleged overcharges because the figures had been redacted."[42]

Throughout the redacted versions of the DCAA audits, crucial auditor findings regarding the reasonableness of Halliburton's prices and the continued deficiencies in the company's systems were also blacked out. The redacted findings include the following:

- The conclusion that Halliburton "did not demonstrate the prices for Kuwaiti fuel and transportation were fair and reasonable" was redacted from DCAA's audit of Task Order 5.[43]

- The conclusion that Halliburton was "unable to furnish sufficient, competent evidential matter to enable a definitive conclusion regarding the reasonableness of the proposed costs" was redacted from DCAA's audit of Task Order 6.[44]

- The conclusion that that Halliburton's "procurement files do not include adequate documentation to justify the selection of other than the lowest bidder" was redacted from DCAA's audit of Task Order 7.[45]

- The conclusion that Halliburton "did not take appropriate action to negotiate better pricing for the fuel and transportation costs" was redacted from DCAA's audit of Task Order 8.[46]

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[41] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 10*, *supra* note 17, at 2.

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

[43] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 5*, *supra* note 17, at 12.

[44] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 6*, *supra* note 17, at 10.

[45] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 7*, *supra* note 17, at 14.

[46] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 8*, *supra* note 17, at 1.

- The conclusion that Halliburton's "purchase order files submitted to us do not include adequate documentation to demonstrate the reasonableness of the Kuwait fuel prices over the life of the purchase orders" was redacted from DCAA's audit of Task Order 9.[47]

- The conclusion that "[w]e consider KBR's estimating system inadequate" and "[w]e have found significant purchasing system deficiencies during related audits" was redacted from DCAA's audit of Task Order 10.[48]

In addition to the audits described above, the Subcommittee obtained DCAA audits that were withheld in their entirety from the IAMB. In February 2005, DCAA completed updated audits for Task Orders 5, 7, 8, 9, and 10.[49] The Defense Department provided none of these updated audits to the IAMB, even in redacted form. In fact, it does not appear that the Defense Department ever informed international auditors of the existence of these audits. The Administration has provided no explanation for how withholding these updated audits from the IAMB complies with U.N. Security Council Resolution 1483.

The Administration has also prevented the IAMB from making its own attempts to examine Halliburton's sole-source contract. Frustrated by the Administration's repeated failure to produce audits of Halliburton's Iraqi oil contract, the IAMB decided at its June 22, 2004, meeting to exercise its authority under Resolution 1483 "to commission a special audit to determine the extent of sole-sourced contracts."[50] This special audit could not proceed, however, until the Administration awarded a contract for the work. On September 8, 2004, the IAMB announced that "[t]he special audit requested by the IAMB ... has yet to be commissioned."[51] Even now, more than nine months after the IAMB's decision, the Administration has yet to award the contract.[52]

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[47] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 9*, *supra* note 17, at 10.

[48] *Report on Audit of Proposal for Restore Iraqi Oil Task Order No. 10*, *supra* note 17, at 24-25.

[49] DCAA Audits, *supra* note 26.

[50] International Advisory and Monitoring Board, *Press Release* (June 22, 2004).

[51] International Advisory and Monitoring Board, *Press Release* (Sept. 8, 2004). *See also* International Advisory and Monitoring Board, *Press Release* (Dec. 14, 2004) (noting that nearly six months after the IAMB ordered a special audit, the Administration had merely provided the IAMB with "terms of reference" for the audit).

[52] *See, e.g.*, *Now You See It: An Audit of KBR*, New York Times (Mar. 20, 2005) (quoting Pentagon spokeswoman as stating: "Procuring the services of an internationally recognized auditing firm to conduct the special audit is ongoing").

Lack of Explanation on Withholding Information on Overcharges

In my March 15 letter, I presented evidence that the Administration allowed Halliburton to make the improper redactions to the DCAA audits provided to the IAMB. Specifically, Halliburton sent a letter to the U.S. Army Corps of Engineers on September 28, 2004, stating that Halliburton officials had redacted not just proprietary business information, but all portions of the audits that they "believe are factually incorrect or misleading."[53]

According to national experts, conclusions by government auditors about contractor overcharges are not proprietary information that can be withheld under the Freedom of Information Act. For example, J. William Leonard, the Director of the Information Security Oversight Office of the National Archives and Records Administration, testified that he has "never encountered" a case in which the government has withheld as proprietary business information the actual amount a company overcharged the government, as determined by government auditors.[54] Mr. Leonard also said that he "would be hard pressed to readily come up with a rationale" for such a withholding.[55] Harold C. Relyea of the nonpartisan Congressional Research Service agreed, stating: "It's hardly proprietary information."[56]

Similarly, Thomas M. Susman, an attorney and regulatory expert who examined Halliburton's redactions in detail, explained that FOIA does not permit a contractor to redact audit information it simply disagrees with. According to Mr. Susman, in this case Halliburton "proposed redacting anything that could be embarrassing to the company plus anything it disagreed with."[57] He added, "they apparently felt they could get away with this."[58]

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

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

[55] *Id.* Indeed, the Pentagon itself previously treated Halliburton's overcharges under this contract as public information. At a December 11, 2003, press conference, DCAA officials publicly announced their preliminary findings of a $61 million overcharge by Halliburton for the gasoline imported from Kuwait. *See* U.S. Department of Defense, *News Briefing* (Dec. 11, 2003).

[56] *Id.* Both Mr. Leonard and Mr. Relyea also agreed that it would be improper for an agency to abdicate the responsibility to make its own assessment on the propriety of such redactions. Mr. Relyea characterized an agency's uncritical acceptance of a company's redactions as "a terrible abrogation of responsibility."

[57] *Now You See It: An Audit of KBR*, New York Times (Mar. 20, 2005).

[58] *Id.*

Since Halliburton's overcharges became public, neither Halliburton nor the Administration has provided a satisfactory explanation for why they concealed these overcharges from U.N.-sanctioned auditors. Halliburton spokesperson Wendy Hall stated that FOIA allows Halliburton to redact "confidential commercial information."[59] Similarly, Army Corps of Engineers spokesperson Carol Sanders stated that the audits contained "confidential commercial information."[60] While both statements are technically accurate, they do not justify efforts to conceal government auditor conclusions that Halliburton overcharged under the contract. They also fail to explain why the Administration withheld multiple audits in their entirety.

Conclusion

For the past year, multiple congressional committees have been investigating the failings of the U.N. Oil for Food Program in minute detail. Since April 7, 2004, there have been 11 congressional hearings on allegations of U.N. malfeasance related to the program. Another hearing is scheduled tomorrow in the Subcommittee. Yet during the same period — despite growing evidence of waste, fraud, and abuse — there have been no congressional hearings into the U.S. administration of the DFI, the successor to the Oil for Food program. Even the January 2005 report of the Special Inspector General for Iraqi Reconstruction, which found that U.S. officials could not properly account for nearly $9 billion in DFI funds, failed to trigger congressional hearings.

This double standard has affected congressional and public understanding of the two programs. Since May 22, 2003, the date the DFI was established, there have been over 2,700 articles in major newspapers that cite the Oil for Food program, compared to fewer than 170 articles that cite the DFI. Congress' reputation among our allies has also suffered from the perception that Congress is eager to draw attention to U.N. faults but reluctant to examine the mistakes and mismanagement of a Republican Administration.

Under your leadership, the Subcommittee has been an exception to the double standard. In addition to subpoenaing DFI records from the Federal Reserve Bank of New York, you and your staff pushed the Pentagon to turn over the full and unredacted DCAA audits discussed above. As a result of your efforts, we now know that Halliburton's overcharges have doubled to over $212 million and that the efforts to conceal these overcharges from the U.N. were more widespread than previously known.

Given these new developments, I renew my request that the Subcommittee hold hearings on the Administration's mismanagement of Iraqi oil proceeds in the DFI and its failure to

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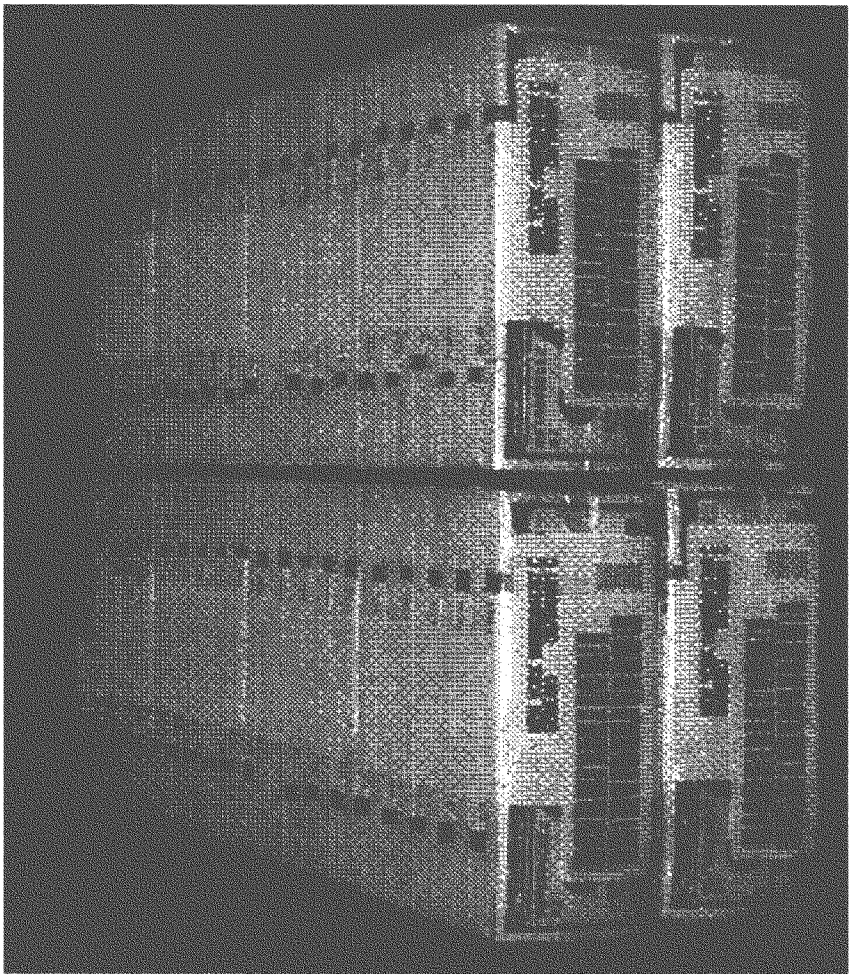
[59] *Halliburton Charged Too Much for Fuel, Say Auditors*, Reuters (Mar. 15, 2005).

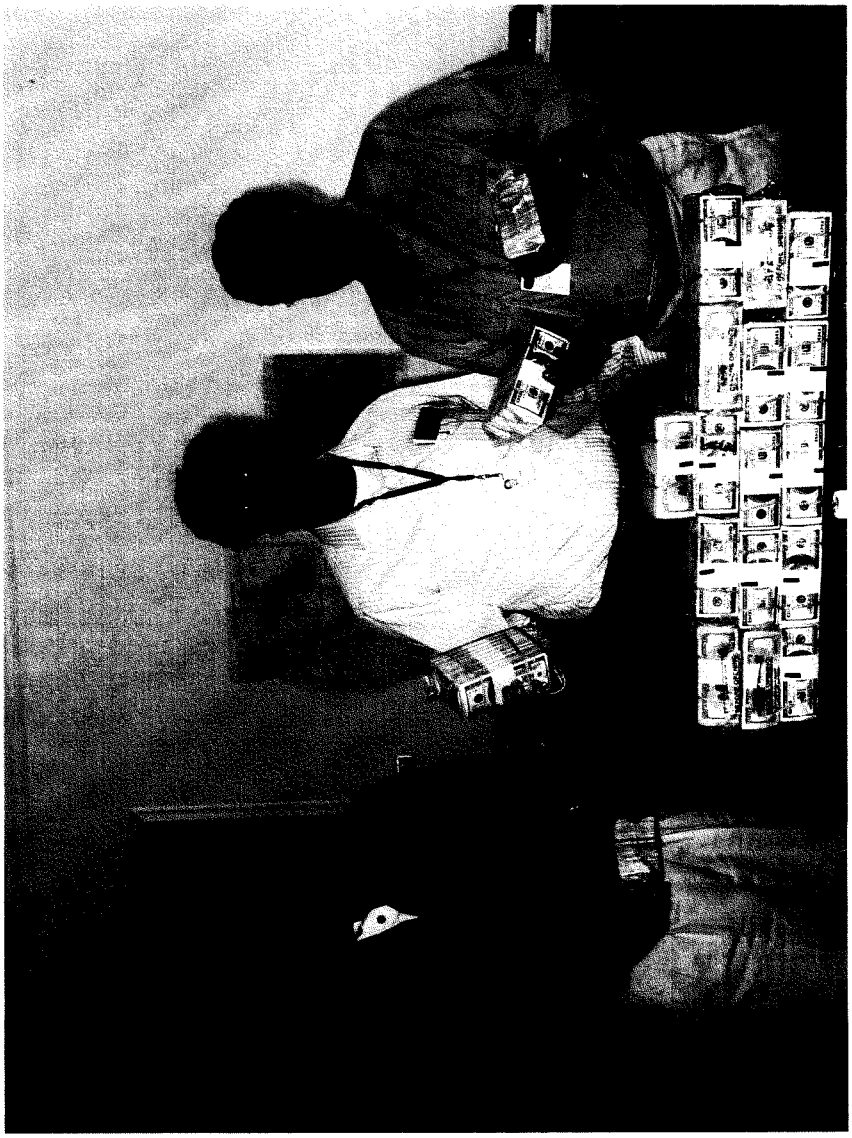
[60] *Pentagon Says Halliburton Paid Too Much for Fuel*, Washington Post (Mar. 15, 2005).

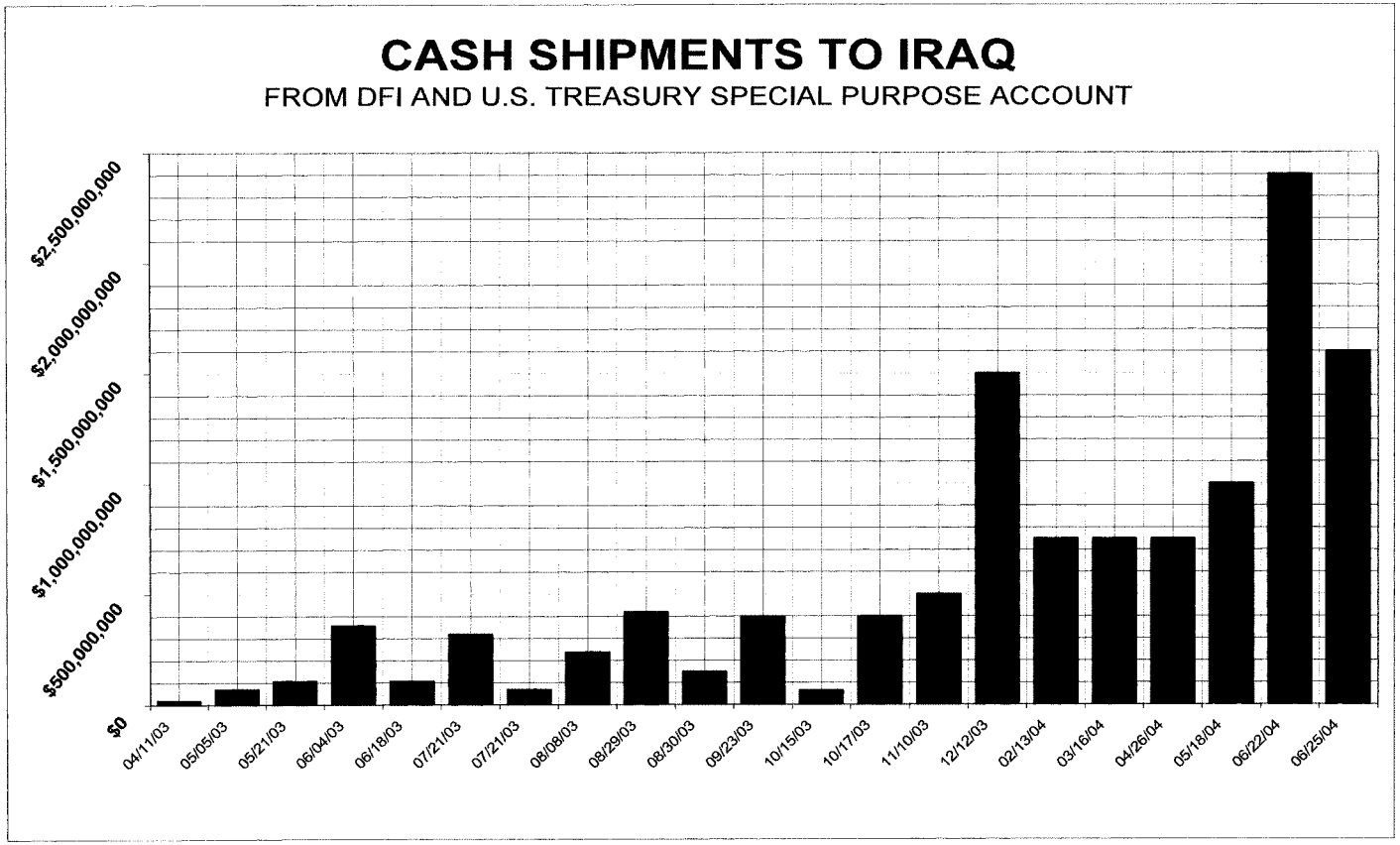
comply with U.N. Security Council Resolution 1483. I commend you for the steps you have taken and look forward to working with you on this important matter.

Sincerely,

Henry A. Waxman
Ranking Minority Member






CASH SHIPMENTS TO IRAQ
FROM DFI AND U.S. TREASURY SPECIAL PURPOSE ACCOUNT
$2,500,000,000
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Mr. SHAYS. At this time the Chair would recognize Mr. John Duncan from Tennessee.

Mr. DUNCAN. Thank you, Mr. Chairman. Thank you for calling this very important hearing.

You said in your statement this hearing builds on the Government Reform Committee's assessment of Iraq reconstruction contracting and financial management and asks specifically how one member of the Coalition, the United States, met that fiduciary commitment to transparency. I can tell you that if there was a fiduciary commitment by the United States, it has been met many billions of times over.

Lawrence Lindsey, who was chairman of the President's Council for Economic Advisors, said before the war started that the war would cost us $100 to $200 billion. He lost his job over that statement. When I went for a briefing at the White House, I specifically asked whether that statement was accurate, and I was told by then National Security Council advisor Rice that, "Oh, no, the war would not cost nearly that much." Now, of course, we know that by the end of September we will have spent $300 billion in Iraq and Afghanistan, 95 percent of it probably in Iraq, and a figure so huge that it is humanly incomprehensible.

Secretary Wolfowitz said or implied or led people to believe in many statements that he made that most of the costs of reconstruction in Iraq would be paid for from their oil proceeds. Of course, we know that is not even close to being accurate now.

Senator Hagle, a member of our own party, said a couple of days ago that things are not getting better in Iraq, they are getting worse. I do not know whether that is true or not. I hear somebody else say that the media is not reporting all the good things that are happening. Well, I can tell you this, I hope for the expenditure of $300 billion there should have been many, many, many good things happening.

When I think back to several months after this war started, a conservative syndicated columnist, George M. Guyer, wrote this, "Critics of the War against Iraq have said since the beginning of the conflict that Americans, still strangely complacent about overseas wars being waged by a minority in their name, will inevitably come to a point where they will see that they have to have a government that provides services at home or one that seeks empire across the globe."

Thank you, Mr. Chairman.

Mr. SHAYS. At this time the Chair would recognize Mr. Higgins from New York.

Mr. HIGGINS. Thank you, Mr. Chairman. I just wanted to say that, first of all, your thorough review of this issue and its importance relative to transparency, relative to accountability I think is critically important at a critically important time. You have done an outstanding job, very thorough, in framing the issue and its inherent problems, and I look forward to the response from this panel of expert witnesses who have been assembled here.

Thank you very much.

Mr. SHAYS. Thank you. I appreciate the gentleman's comments, as I do of all the Members.

Mr. Porter, welcome. Do you have any statement you would like to make?

Mr. PORTER. I have one to submit.

Mr. SHAYS. Thank you. The gentleman will be submitting his statement.

[The prepared statement of Hon. Jon C. Porter follows:]

STATEMENT FOR THE RECORD
CONGRESSMAN JON C. PORTER (R-NV-3)
"THE DEVELOPMENT FUND FOR IRAQ: US MANAGEMENT OF IRAQ OIL PROCEEDS AND COMPLIANCE WITH UN SECURITY COUNCIL RESOLUTION 1483"
JUNE 21, 2005

Mr. Chairman, I would like to thank you for holding this important hearing today and would also like to thank the witnesses for taking time out of their schedules to testify. Their time and input on this issue is very important and sincerely appreciated.

While this hearing seeks to evaluate the actions of the United States with respect to the Iraqi development fund, principal also are the efforts of the Department of Defense in ensuring that every step has been taken to achieve compliance with the requirements of United Nations Resolution 1483.

The ability of the Iraqi government to effectively assume authority relies on the example of United States. Therefore, the Department of Defense should meet compliance requirements and demonstrate to the Iraqi people an appropriate and effective approach to democratic governance.

Also important in this hearing is to determine whether the assumed neglect in oversight that has been attributed to the Department of Defense in contracting and management has been inconsistent with the authority granted under International law. What must be accounted for are the funds that were set aside for humanitarian efforts associated with the internal reconstruction of Iraq. Errors in accounting and the absence of documentation required as a method of meeting transparency requirements are simply unacceptable. These small missteps in management only complicate the ability of the Iraqi government to effectively assume control of their burgeoning democracy.

As American people continue to fight gallantly for the freedom and stability of the Iraqi people and as the government of Iraq seeks to rebuild its nation and establish democratic values, we must work to ensure that the American government is doing everything within its power and ability to fulfill the humanitarian efforts of rebuilding and development for the Iraqi people.

Mr. Chairman, thank you for this time and I look forward to hearing the testimonies of the witnesses on this very important issue.

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Mr. SHAYS. Let me just say as strongly as I can that there is no disagreement, I think, among majority and minority that we want and expect full cooperation from the administration and the Department of Defense. Newt Gingrich told me that we are not in Congress a Parliament, we are a separate branch of government. I think we do a disservice to the American people and to DOD when we allow things to happen without the proper questions.

I was very interested in the hearings that had been conducted to date, and I felt that DOD had a good story to tell and I wondered why it was so darned reluctant to tell the story, and it only to me adds to the suspicions that maybe the story is not a good story. So on this issue today, right now, the agreement I think you see on both sides is we do not want redactions, we want cooperation. This committee is doing an investigation of the Oil-for-Food Program. We are outraged at the lack of transparency that we saw at the United Nations, the lack of transparency that we have seen with its member nations with regard to the Oil-for-Food Program, and I am faced as chairman with the fact that we see this same reluctance to provide information. It just undermines any criticism we may have of others for the same reason.

I think ultimately that the issue of money not accounted for will be resolved, so I agree on the redaction issue but disagree with the conclusion at this time that DCAA audit findings constitute overcharges, much like a doctor submitting a request to the insurance company and the insurance company says, "No, there are overcharges. We do not agree with them." That is what I think this process is about. But I also think in the end we will find there are some overcharges, and that is what we want to know. How much? We need your cooperation.

At this time I think the gentleman, the ranking member, has a request for some time.

Mr. WAXMAN. Mr. Chairman, I would like to be recognized to make a motion for a subpoena under House Rule 112K6.

Mr. SHAYS. The Member is in order to make a motion.

Mr. WAXMAN. I move that the subcommittee issue a subpoena for the documents that the Defense Department has refused to turn over voluntarily in response to our bipartisan request. In particular, I ask that the subcommittee subpoena all records relating to the Department's decision to conceal Halliburton's overcharges from the international auditors at the IAMB.

Mr. Chairman, as you know, U.N. Security Council Resolution 1483 requires the United States to spend Iraqi funds in a transparent manner. In violation of this requirement, however, the Defense Department tried to conceal over $200 million in Halliburton overcharges from the United Nations auditors. These vast overcharges were billed by Halliburton to the Army Corps of Engineers, but the Defense Department officials decided that over $170 million in overcharges should be paid out of the Iraqi funds in the DFI, and then they decided that to hide all information about the amount of the overcharges from the reports given to U.N. auditors. We know that they handed over statements with a lot of redactions, and the redactions all dealt with the billings from Halliburton.

At a briefing last week we learned some other disturbing facts. First, Department officials confirmed that Halliburton requested each of the 463 redactions in the audits, and that every single redaction requested by Halliburton was accepted by the Defense Department. In effect, U.S. officials inverted the proper roles of government and contractor, giving Halliburton unprecedented authority to withhold key parts of Defense Department audits.

Second, we learned that the decision to conceal the overcharges was made after consultation with multiple offices in the Pentagon, including the Office of Deputy Secretary Paul Wolfowitz, the Office of General Counsel, and the Comptroller. And when officials from the Corps of Engineers urged a "sanity check," their calls went unheeded.

We were even told that lawyers in the General Counsel's office threatened Department officials with criminal charges if they disclosed any information about the overcharges without Halliburton's permission. There was absolutely no legal justification for these actions. Department lawyers said that Halliburton overcharges should not be disclosed because they would reflect unfavorably on the company and impair its ability to obtain future contracts. That is what Department lawyers were saying. They apparently forgot that they work for the Federal taxpayers, not Halliburton.

Mr. Chairman, you and I have been trying for months on a bipartisan basis to obtain the documents that would explain why the Department concealed the overcharges from the U.N. auditors in violation of the Security Council resolution. On April 14, 2005, we sent a joint letter to Secretary Rumsfeld asking for the identities of those responsible for these redactions, and for documents and other correspondence with Halliburton and within the Pentagon that would expose the rationale for the withholding. We asked for this information by May 27th so that we would have it for today's hearing. I want to make this letter part of the hearing record, as well.

We received no response from the Defense Department. As a result, you then sent a second letter on May 23, and I want this letter also to be made part of the hearing record.

In addition to these written requests, our staffs have made repeated efforts to obtain these documents, but to no avail. They sent at least nine e-mail requests and also made repeated telephone and in-person requests.

Despite all of this effort, we have not received a single document. I know that your policy as chairman is to first send a letter requesting documents before issuing a subpoena. In this case, we have sent two written requests, made countless informal requests, but the Defense Department has produced a total of zero documents.

Mr. Chairman, we have been extremely patient, but this is not an isolated occurrence. First, the Department defied the Security Council by concealing Halliburton's overcharges, then it defied Congress by withholding the unredacted audits, now it is trying to cover up evidence of its violations. This pattern of obstruction leaves us no choice but to subpoena the documents, and I therefore move that the committee compel Defense Secretary Donald Rumsfeld to produce the documents specified in the subpoena.

Mr. SHAYS. If the gentleman would yield?

Mr. WAXMAN. Certainly.

Mr. SHAYS. While I may disagree on the term overcharge, I am in total agreement with the gentleman. We did send this letter and we did request that it be here on May 27th. For the edification of the entire committee, they are overdue, obviously. It was supposed to be in by May 27th.

We continued to request this information since that date verbally. I would even say we begged for the information. I would say that we not only begged for it, we said, just give us some, so that when we had this hearing we could say there was a good faith effort to cooperate.

We have no information, and I would say to the gentleman that it would be my request that at this time he withdraw his motion, that I will request from Mr. Davis, the full committee chairman, that if we do not get this information by next Monday that I will request that he consider and I would certainly advocate that we subpoena the information. I would like to do it with the full committee, and would just say to the gentleman that it takes 11 members of this subcommittee to make such a motion. I agree with his request. My request is that we work through the full committee for that information.

Mr. WAXMAN. Mr. Chairman, I respect your request to me and I am going to accede to that request and withdraw this motion, but I do feel strongly that Congress should not have to grovel to get information. This is information we are entitled to.

I know you are giving them a little bit more time, so they are only 30 days out after the time we specified for them to comply, and I respect the fact that you will join with me in urging a subpoena if we do not get the information. On that basis, I will withdraw my motion, but I would request of you that, if a majority of this subcommittee appeals to the chairman for a subpoena, I would inquire whether that would be sufficient. I am not sure of the parliamentary procedure.

Mr. SHAYS. Let me just say that Mr. Davis has been extraordinarily helpful in our request to get information. You are right, this committee chairman did grovel, if only to prove a point. But those days have ended and so the fact is that I will strongly advocate and I think other members of this committee would advocate that we get this information on both sides of the aisle to Mr. Davis.

Mr. WAXMAN. Mr. Chairman, I understand that Chairman Davis can issue a subpoena. A majority vote of this subcommittee can also issue a subpoena.

Mr. SHAYS. Right.

Mr. WAXMAN. I will join you in the request to Chairman Davis. I'd like to ask of you that if for some reason we do not get that subpoena in a timely manner that you make available an opportunity for this subcommittee to vote on an issue of subpoena.

Mr. SHAYS. I think that would probably happen.

Mr. WAXMAN. OK.

Mr. SHAYS. It may not happen as quickly as you like, but the gentleman is always free to put another motion in. Withdrawing this motion does not mean you cannot make it again. We will be

meeting for other hearings, and the gentleman can obviously make a motion at that time.

Mr. WAXMAN. Thank you, Mr. Chairman.

Mr. SHAYS. And I am aware of that. Mr. Davis is aware of that. And also I hope DOD is aware of that.

Mr. WAXMAN. Thank you, Mr. Chairman. I ask unanimous consent to withdraw my motion.

Mr. SHAYS. Without objection.

Mr. WAXMAN. I ask that two letters be made part of the record, and I'd like to have unanimous consent.

Mr. SHAYS. Without objection.

[The information referred to follows:]

TOM DAVIS, VIRGINIA,
CHAIRMAN

CHRISTOPHER SHAYS, CONNECTICUT
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ILEANA ROS-LEHTINEN, FLORIDA
JOHN M. McHUGH, NEW YORK
JOHN L. MICA, FLORIDA
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BERNARD SANDERS, VERMONT,
INDEPENDENT

SUBCOMMITTEE ON NATIONAL SECURITY, VETERANS AFFAIRS,
AND INTERNATIONAL RELATIONS
Christopher Shays, Connecticut
Chairman
Room B-372 Rayburn Building
Washington, D.C. 20515
Tel: 202 225-2548
Fax: 202 225-2382

April 14, 2005

The Honorable Donald H. Rumsfeld
Secretary
Department of Defense
1000 Defense Pentagon
Room 3E880
Washington, D.C. 20301-1000

Dear Mr. Secretary:

The Subcommittee is conducting oversight of U.S. compliance with United Nations Security Council Resolution 1483, which requires that the expenditure of Iraqi oil proceeds and other funds in the Development Fund for Iraq (DFI) be done "in a transparent manner."

In response to our letter request of October 5, 2004, the Department provided several audit reports by the Defense Contract Audit Agency regarding work by Halliburton subsidiary KBR under the Restore Iraqi Oil contract awarded by the U.S. Army Corps of Engineers. According to the Army Corps, approximately $1.6 billion of DFI funds were used to pay KBR under this contract. The audit reports provided to the Subcommittee show that DCAA identified overcharges and questioned costs of approximately $212 million under this contract. However, when the U.S. provided these audit reports to the International Advisory and Monitoring Board, the organization charged under Resolution 1483 with monitoring the transparency of DFI expenditures, all references to overcharges were redacted.

In order to understand the rationale for these redactions, we request that the Department provide the following documents to the Subcommittee:

- Unredacted copies of all correspondence (whether written or electronic) between KBR and the Department of Defense regarding redactions to the DCAA audits of the Restore Iraqi Oil contract, including but not limited to suggested redactions by KBR.

- Unredacted copies of all correspondence (whether written or electronic) between KBR and the Department of Defense regarding the International Advisory and Monitoring Board (IAMB).

- Unredacted copies of all Department of Defense documents (whether written or electronic) relating to redactions to the DCAA audits of the Restore Iraqi oil contract.

- Unredacted copies of all Department of Defense documents (whether written or electronic) regarding which documents would or would not be provided to the IAMB and what form those documents would take.

- A list of all Department of Defense employees who participated in reviewing KBR's suggested redactions to the DCAA audits of the Restore Iraqi oil contract, including job title and contact information for each employee.

- A list of all Department of Defense employees who participated in the preparation of the DCAA audits of the Restore Iraqi oil contract, including job title and contact information for each employee.

Please provide the documents to the Subcommittee offices by 5 p.m. on Friday, May 27, 2005. If you have any questions about this request, please contact J. Vincent Chase of Chairman Shays' staff at (202) 225-2548 or David Rapallo of Ranking Member Waxman's staff at (202) 225-5420. Thank you for your assistance in this matter.

Sincerely,

Christopher Shays
Chairman
Subcommittee on National Security,
Emerging Threats and International Relations

Henry A. Waxman
Ranking Minority Member
Committee on Government Reform

TOM DAVIS, VIRGINIA,
CHAIRMAN

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May 23, 2005

The Honorable Donald H. Rumsfeld
Secretary
Department of Defense
1000 Defense Pentagon
Room 3E880
Washington, D.C. 20301-1000

Dear Mr. Secretary:

The Subcommittee on National Security, Emerging Threats, and International Relations has jurisdiction over matters affecting the "overall economy, efficiency and management of government operations and activities..." (Rule X, clause 1(h)(6), Rules of the House of Representatives).

Pursuant to that oversight jurisdiction, and the Subcommittee's continued interest in Iraqi contracting and reconstruction efforts by the U.S. government, the Subcommittee requests meetings with several Defense Department offices, including the office of the Comptroller, DSO, Deputy Secretary of Defense, and any other offices with responsibilities relating to the Development Fund for Iraq (DFI), the U.S. government's compliance with U.N. Security Council Resolution 1483, or interaction with the International Advisory and Monitoring Board (IAMB).

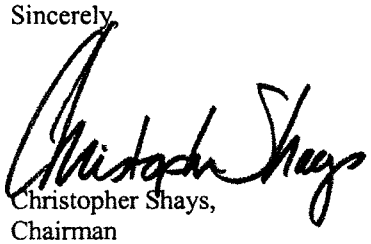
The Subcommittee is specifically interested in learning the Department's responses to several audits of the DFI, including reports by the Special Inspector General for Iraq Reconstruction and KPMG.

The Subcommittee is also interested in the process by which the Department made, approved of, or accepted redactions to several Defense Contract Audit Agency reports submitted to the IAMB. The Subcommittee made a request on April 14, 2005, for documents relating to these redactions, including documents from the Army Corps of Engineers, the Comptroller's office, the Office of the Secretary of Defense, or any other offices that were involved in this process. As a reminder, the date set for requested delivery of those documents is this Friday, May 27, 2005.

Therefore, at your earliest convenience, please contact Subcommittee offices to schedule a briefing on the DFI and provide a status update on the request for documents relating to DCAA audit redactions. If you have any questions about this request please contact Lawrence Halloran or Vincent Chase at (202) 225-2548.

As mentioned in my letter of May 18, 2005, the Subcommittee is conducting an investigation of the DFI, which will include future requests for information and interviews of Defense Department personnel. Please consider this letter as a formal request for additional interviews and materials that will be identified to your staff.

Sincerely,



Christopher Shays,
Chairman

cc:

The Honorable Tom Davis
The Honorable Henry A. Waxman
The Honorable Kenny Marchant

Mr. SHAYS. Mr. Kucinich, do you have any——

Mr. KUCINICH. Yes. As the ranking member on the subcommittee I want to support the direction that the Chair and our ranking member of the overall committee have recommended here. You used the term "gentleman" in a way that creates comity here. Our chairman has, indeed, been a gentle man in his approach toward this issue, and I think that it would be a mistake for anyone to mistake his gentleness for a lack of commitment to the taxpayers of this country. I want to thank Mr. Shays for the direction he's taking this and let him know that he has my full support.

Thank you.

Mr. SHAYS. I thank the gentleman. Just one other clarification before we recognize our witnesses. Ambassador Bremer's participation was not requested by this subcommittee because the primary focus is on the redacted information. Obviously, he may choose to participate. The full committee may choose to ask him to come in at some time. But, just for the record, he was never consulted, he was never requested to participate, and that is why you do not see his presence here today.

Mr. WAXMAN. Would the gentleman yield?

Mr. SHAYS. I would be happy to yield.

Mr. WAXMAN. I appreciate the gentleman for noticing that. I also think that, given the gravity of this situation where nearly $9 billion is unaccounted for, that Mr. Bremer would be happy to come forward without the committee making the request.

Thank you.

Mr. SHAYS. I ask unanimous consent that all members of the subcommittee be permitted to place an opening statement in the record and that the record remain open for 3 days for that purpose. Without objection, so ordered.

I ask further unanimous consent that all witnesses be permitted to include their written statements in the record. Without objection, so ordered.

At this time the Chair would recognize our first panel: Mr. Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction, Department of Defense; Mr. William Reed, Director, Defense Contract Audit Agency [DCAA], Department of Defense; Colonel Emmett H. DuBose, Jr., Deputy Commander of the Southwestern Division, U.S. Army Corps of Engineers, Department of the Army; Mr. Joseph A. Benkert, Deputy Director of Defense Reconstruction Support Office, Office of the Secretary of Defense; and Mr. David Norquist, Under Deputy Secretary of Defense for Resource Planning and Management, Department of Defense.

At this time, gentlemen, as you know, we swear in all witnesses and request that you stand and be sworn in.

Let me say if you think there is anyone else you think you may draw on to make testimony, it would be better if they stand up now so that we do not have to swear them in. And if they are asked to testify, we will take their name and give it to the transcriber.

Please raise your right hands.

[Witnesses sworn.]

Mr. SHAYS. Thank you, gentleman. You all responded in the affirmative.

Mr. Bowen, we are going to start with you. I know we have a fairly large panel, but we will go 5 minutes. We will roll over another 5 minutes if you creep into the next 5. We definitely stop you after 10, but we definitely prefer you be closer to 5 than 10, but frankly your testimony is very important and we want that testimony on the record. Your full statements will obviously be on the record, but we want you to feel free to say whatever you need to say.

Thank you, Mr. Bowen.

STATEMENTS OF STUART W. BOWEN, JR., SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION, DEPARTMENT OF DEFENSE; COLONEL EMMETT DUBOSE, DEPUTY COMMANDER, U.S. ARMY CORPS OF ENGINEERS, DEPARTMENT OF THE ARMY, ACCOMPANIED BY J. JOSEPH TYLER, P.E., CHIEF, PROGRAMS MANAGEMENT DIVISION, DIRECTORATE OF MILITARY PROGRAMS, U.S. ARMY CORPS OF ENGINEERS; WILLIAM REED, DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY, DEPARTMENT OF DEFENSE; JOSEPH A. BENKERT, DEPUTY DIRECTOR OF DEFENSE RECONSTRUCTION SUPPORT OFFICE, OFFICE OF SECRETARY OF DEFENSE; AND DAVID NORQUIST, UNDER DEPUTY SECRETARY OF DEFENSE FOR RESOURCE PLANNING AND MANAGEMENT, DEPARTMENT OF DEFENSE

STATEMENT OF STUART W. BOWEN

Mr. BOWEN. Thank you. Good morning.

Mr. SHAYS. Good morning.

Mr. BOWEN. Chairman Shays, Ranking Member Kucinich, and members of the subcommittee, I am Stuart Bowen, the Special Inspector General for Iraq Reconstruction. Thank you for allowing me to address your subcommittee about the U.S. role in Iraq's reconstruction and to testify about my organization's involvement in auditing the development fund for Iraq.

This is my first appearance before the Congress since I was appointed the Coalition Provisional Authority's Inspector General in January 2004. I carried out my duties as the CPA IG until October 2004, when Congress reauthorized my organization and redesignated me as the Special Inspector General for Iraq Reconstruction.

The Congress has directed the SIGIR to audit and investigate the programs and operations funded by the Iraq Relief and Reconstruction Fund [IRRF], and to report our findings to the Secretaries of Defense and State and to the Congress.

I have just returned, as well, Mr. Chairman, from my eighth trip to Iraq, and I am pleased to report that my organization is operating at optimal levels, that we are carrying out the mission that you have assigned us with skill, speed, and precision, and that we will soon have 45 personnel on the ground in Iraq carrying out that job, composed of auditors and investigators.

I am proud of those on my staff who volunteered to serve in this high-threat environment that is Iraq today, and they know, they have heard from me, that they are the taxpayers' watchdog on the ground in Iraq covering Iraq reconstruction.

We are effectively promoting economy, efficiency, and program results, and we are deterring fraud, waste, and abuse. To date, SIGIR has submitted five quarterly reports to the Congress, the most recent being our April 30, 2005, report, and we have completed 19 audit reports and have 8 more underway and much more to come. Our reports are available at our Web site, WWW.SIGIR.MIL in English and Arabic.

You invited me today, Mr. Chairman, to testify about the audits we issued that addressed the Development Fund for Iraq. First off, let me point out the DFI is Iraqi money, not U.S. money. It is comprised of Iraqi oil revenues, primarily, as well as other assets accumulated for the rebuilding and operation of Iraq. Four of our published audit reports have addressed the DFI, and I have submitted them for the record. We have four more audits still underway that will continue to address the DFI.

As has been referenced, our January 30, 2005, audit report reviewed the CPA's oversight of DFI funds provided to ministries of the Iraqi interim government through the national budgeting process. That audit addressed $8.8 billion of the DFI disbursed by the CPA to the Iraqi government pursuant to U.N. Security Council Resolution 1483. The audit attracted substantial attention.

There have been some misinterpretations about exactly what we said, so let me be clear about what the audit did not say. It did not say that the money was lost. It did not say that the money was stolen. It did not say that the money was fraudulently disbursed by U.S. authorities.

What we did say was this: One, the CPA provided less-than-adequate controls over DFI funds provided to Iraqi ministries through the national budget process; two, the CPA failed to establish or implement sufficient managerial, financial, and contractual controls to ensure that DFI funds were used in a transparent manner—three facets of analysis there: managerial, financial, and contractual—and tied to the 1483 standard of review, transparency; three, there were no assurances, thus, that DFI funds were used for the purposes mandated by U.N. Security Council Resolution 1483, namely and primarily for the benefit of the Iraqi people.

SIGIR has completed three other DFI audits. One addressed how the comptroller managed DFI cash. We found problems there and we brought them to the comptroller's attention. They concurred and corrected those problems.

And let me just make an aside here. One of my goals—my philosophy as an IG here, because we are a temporary organization, is when I find problems to bring them to management's attention and to correct them so that taxpayers' money is saved today and that those reports of losses are not first realized by management and the Congress later when audit reports are published. I think we succeeded and will continue to succeed in that regard. Our last quarterly report had 28 findings, virtually all of them resolved.

The other audits that we have done regarding DFI, the south-central paying office in Hillah, DFI issues, many of them arose. We have four more audits coming from that. In this case we did find indicators of fraud, and from this case we have opened a series of investigations that are pending at various stages of review, both within our office and before the U.S. attorney.

We also completed an audit on the management of the $2.8 billion of DFI money put in the sub-account to manage contracts post June 28th, and we found problems there—lack of specificity, lack of visibility about the amounts that remain in those accounts, the amounts paid out in specific contract actions. Again, those were concurred in by management and steps to correct those were implemented.

Let me conclude by saying that, having completed my eighth trip, I am encouraged by the receptivity of the current Iraq reconstruction management teams to our advice, and I am confident that we will continue to promote cost-saving measures to those teams and that we will be able to look at the continuum of Iraq reconstruction management as one of gradual improvement. We will continue to play our role and fulfill the mission you have assigned us.

Thank you. I look forward to answering your questions.

[The prepared statement of Mr. Bowen follows:]

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HOUSE COMMITTEE ON GOVERNMENT REFORM

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

BEFORE THE

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

Tuesday, June 21, 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.

This is my first appearance before any committee of the Congress since I was appointed to help oversee Iraq reconstruction in January 2004. I look forward to a productive exchange of views with you, which I hope will raise public awareness of, and congressional attention to, the progress our Nation has made in the reconstruction and rehabilitation of Iraq and the challenges we continue to face in this important endeavor.

Background of the Office of Special Inspector General for Iraq Reconstruction

The Office of the Special Inspector General for Iraq Reconstruction (SIGIR) is the successor to the Coalition Provisional Authority Office of Inspector General (CPA-IG).

Under its enabling statute, the CPA-IG was scheduled to terminate six months after the dissolution of the Coalition Provisional Authority (CPA). The CPA passed sovereignty to Iraq on June 28, 2004, and thus the CPA-IG ostensible termination date became December 28, 2004.

Congress recognized the need to continue special oversight of the U.S. role in Iraq's Reconstruction, and thus it amended the CPA-IG enabling statute and re-

designated the CPA-IG as the Office of the Special Inspector General for Iraq Reconstruction. Without enactment of this amendment, which became law on October 29, 2004, the CPA-IG would have ceased operations at the end of 2004.

The signing of The National Defense Authorization Act for FY-2005 effected several changes, including the re-designation of CPA-IG as SIGIR. It also directed that SIGIR report jointly to the Secretaries of State and Defense, and that the SIGIR audit and investigate programs and operations funded by the Iraq Relief and Reconstruction Fund – known as the "IRRF."

During 2004, my organization completed and published 14 audit reports covering a wide range of issues from CPA's management of the Development Fund for Iraq to contracting practices. Through most of last year, I maintained an audit staff in Baghdad of about 15 auditors and an investigative team of about five criminal investigators. My staffs in Baghdad and Arlington began to decrease during the latter part of 2004 as the CPA-IG sunset approached. Most of our employees were detailed from other federal agencies, chiefly the Department of Defense, and as their assignments expired, those agencies generally did not provide extensions or replacements as they expected our oversight would soon terminate.

With the passage of the 2005 Defense Authorization Act authorizing our continued operation, SIGIR moved quickly to hire a new cadre of auditors and criminal investigators. We have successfully reenergized our organization and will soon have 45 personnel deployed to Baghdad.

I am very proud of my staff's willingness to serve in the highly hazardous environment that is Iraq today. They are a dedicated cadre of professionals; 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.

I believe that SIGIR is the point of the spear for oversight in Iraq; we are carrying out the mission that the Congress has assigned, with vigor, speed, and efficiency. In a nutshell, SIGIR is the "Taxpayers' Watchdog" for the Iraq reconstruction program.

On-Going Activities

About two weeks ago, I returned from my eighth trip to Baghdad. I am satisfied that our organization is now operating at optimal levels, and our auditors and investigators are performing SIGIR's mission in a way that will keep Americans informed about how their tax dollars are being spent on reconstruction. SIGIR has a substantial presence in Iraq that ensures a thorough knowledge of reconstruction operations and a forward-leaning familiarity with those who are managing the reconstruction effort.

SIGIR is making a meaningful impact on the fight against fraud, waste, and abuse. To that end, I have directed my staff to be actively engaged so that our oversight profile deters wrongful or wasteful conduct before it happens. Given the fact that SIGIR is a temporary organization, I want to ensure that the effect of our oversight is "real time," which differs somewhat from the typical Inspector General's approach. My goal is to correct inefficiencies as we find them so that we can save taxpayer dollars today, rather than observe and report about such losses at a later date.

I should add that we work closely with other oversight organizations that have jurisdiction over Iraq through a SIGIR-developed initiative: the Iraq Inspectors General Council. The Council meets at least quarterly to discuss and coordinate oversight activities in Iraq, to avoid unnecessary duplication of effort, and to raise awareness of possible gaps in oversight coverage.

Our work to promote the economic and efficient use of U.S. funds provides the Congress and the Executive Branch insight into the challenges arising within the reconstruction program. To date, we have published five Quarterly Reports to Congress, the most recent on April 30, 2005, as well as 19 audit reports, covering a variety of matters important to the management of Iraq reconstruction. Our reports are easily available to the public, in English and Arabic, on our Web site: www.sigir.mil.

It is important that our oversight provide the best usable advice and immediate guidance so that those managing the reconstruction effort can make continuous improvement. As I noted, SIGIR provides what I call "real-time auditing." We see our mission as both accomplishing longer-term analysis and providing expeditious and effective recommendations on the management of Iraq's reconstruction. Our most recent four audit reports are examples of this approach. These audit reports 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.

Some have criticized our assessments for failing to account adequately for the constricting conditions that accompany working in a war zone fraught with danger and uncertainty. I fully understand the nature of those conditions as I and my staff experience them daily in Baghdad. However, the difficulties caused by those conditions underscore the need for fastidious accountability because the danger of fraud, waste, and abuse is potentially higher.

The Development Fund for Iraq (DFI)

You have invited me to testify today specifically on the matter of the Development Fund for Iraq (DFI) and its management by the United States. The DFI is composed of Iraqi oil revenues, unencumbered Oil-for-Food monies, and repatriated Iraqi assets accumulated since May 2003 for the rebuilding of Iraq. The DFI has accumulated $34.5 billion as of our April 30, 2005 Report. While the U.S. transferred control over the

DFI to the Iraqi Interim Government on June 28, 2004, a part of the DFI has remained under U.S. control, specifically $3 billion as of March 2005, to allow the continued management of contracts undertaken before the 2004 transfer of governance.

Our reports about the DFI, chiefly in audit reports summarized in our January 30th and April 30th reports to the Congress, are the result of work we began while meeting our mandate as the CPA Inspector General. Our current statute focuses our oversight to the programs and operations funded by the Iraq Relief and Reconstruction Fund, specifically the $18.4 billion provided in the FY-2004 Supplemental appropriation. Our existing authority no longer extends to funds that are subject to Iraqi governance.

Of the 19 audits we have completed to date, four dealt exclusively with programs and operations funded by the DFI. One of these, published on January 30, 2005, reported on the oversight of DFI funds provided to the ministries of the Interim Iraq Government through the national budget process.

I am submitting SIGIR Audit Report No. 05-004: Oversight of Funds Provided to Iraqi Ministries through the National Budget Process, for the record of this hearing.

This audit addressed $8.8 billion in Iraqi funds overseen by the CPA. The number attracted a lot of attention and led to some misunderstanding. To be clear: our audit report did not say that the DFI was "lost taxpayer money," nor did we allege or imply that U.S. officials had engaged in any fraudulent practices.

Here's what our January 30, 2005 audit report said:

- the Coalition Provisional Authority provided less than adequate controls for approximately $8.8 billion in DFI funds provided to Iraqi ministries through the national budget process;
- specifically, the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner;
- and, consequently, there was no assurance that funds were used for the purposes mandated by [United Nations Security Council] Resolution 1483.

As noted, our DFI audit report did not address U.S. appropriated funds; this distinction does not lessen the importance of our oversight nor of our findings. Indeed, the CPA's management of Iraqi money was an important responsibility that, in my view, required more diligent accountability, pursuant to its assigned mandate, than we found. After many months of careful interviews and scrutiny of the documentation available, my auditors concluded that there were not adequate systems in place to ensure that the CPA knew what happened to the DFI funds after they were disbursed to the Iraqi ministries.

This posed a significant problem to the management of the DFI, which was assigned as a responsibility of the CPA by U.N. Security Council Resolution No. 1483.

This Resolution required that the DFI funds 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;

While acknowledging the extraordinarily challenging threat environment that confronted the CPA, as well as a number of improvements they made to budgeting and financial management for the Iraq Interim Government, we concluded nonetheless that the CPA management of Iraq's national budget process and its oversight of Iraqi funds were burdened by incomplete reporting, inefficiencies, and poor management.

In July 2004, the management in place in Iraq initially concurred with our draft audit findings. However, the Defense Support Office – Iraq (within the Department of Defense) subsequently disagreed with our findings, as did the former Administrator of the CPA, Ambassador L. Paul Bremer. In light of these disagreements, we carefully reviewed our audit findings, delayed publication of the audit report for a number of months, and responded in detail to the issues raised by those disagreeing from our conclusions.

Those who read the audit report will see the complete record of audit findings, management comments, and our responses. Those who disagreed with our comments challenged our findings and conclusions, primarily using the existence of a difficult wartime environment as a defense. Ambassador Bremer cited the lack of a functioning Iraqi government civil service, as well as pay systems corrupted by decades of cronyism and ad Hoc fixes. In my view, the existence of these conditions should have prompted the imposition of more accountability and controls upon the interim Iraqi government structures.

None of the arguments materially moved us from our overarching conclusion that the CPA had failed to establish and implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner; that there was no assurance that the subject funds were used for the purposes mandated by Resolution 1483. In our response, we addressed the core complaint in the following way:

> We fully recognize that the CPA operated in a dangerous working environment under difficult conditions. However, the existing administrative conditions should have underscored the need for controls over the disbursements to the Iraqi ministries. The CPA should have established controls and provided oversight over the financial management of the DFI funds precisely because there was no functioning Iraqi government, no experience within the Ministry of Finance in managing the national budget, no budget or personnel records, and the payroll systems were corrupted by cronyism and ad hoc fixes. On an individual basis, any of these conditions should have sent strong signals to financial managers that weaknesses were widespread, posed unacceptable risks and called for forceful action.

> Those weaknesses should have represented goals for corrective actions, not reasons for inaction.

Three other SIGIR audit reports, one released July 28, 2004 and two released on April 30, 2005, dealt with the management of the DFI. These are submitted for the record of this hearing:

- CPA-IG Audit Report No. 04-009: Coalition Provisional Authority Comptroller Cash Management Controls over the Development Fund for Iraq
- SIGIR Audit Report No. 05-006: Control of Cash Provided to South-Central Iraq
- SIGIR Audit Report No. 05-008: Administration of Contracts Funded by the Development Fund for Iraq

Generally, these audit reports cited weaknesses of controls over DFI money. Whereas the audit report of controls over DFI funds disbursed to Iraqi ministries did not raise issues of potential fraud by U.S. personnel, the audit report of Cash Provided to South-Central Iraq did find indications of fraud; we now have criminal investigations underway that will ferret out this wrongdoing. The issues raised about shortcomings in continuing management of DFI contracts in our audit report of the administration of DFI contracts are being addressed by management.

Conclusion

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 with management to save taxpayer dollars today. The Iraq reconstruction program is rapidly moving forward.

For SIGIR to make a meaningful difference, we must continue to utilize the concept of "real time" auditing. In general practice, audits usually provide detailed and documented retrospective criticism of how money could have, or should have been saved, if more efficient measures had been mandated by management. SIGIR works to close that reporting gap by pursuing a balanced approach – that is, working with management to make changes now, while retaining our required detachment as an oversight organization. I believe that this approach maintains our reportorial integrity, while promoting our collective goal – the highest and best use of U.S. resources in the Iraq reconstruction program.

As I said, I recently returned from my eighth trip to Baghdad. I am very encouraged by the response to our efforts to promote efficiency of the current Iraq reconstruction management teams: the Project and Contracting Office (PCO), the Multi-National Security Transition Command - Iraq (MNSTC-I), and at the U.S. Agency for International Development (USAID). I commend the PCO management in particular for giving me and my staff complete access to their operations and for responding to our advice and recommendations in "real time."

To be sure, those working to manage the reconstruction of Iraq are laboring under very difficult conditions. In light of those conditions, I have told my staff that SIGIR will not hide our potential findings until publication of an audit. Rather, we will lean forward in a transparent manner to provide management with constructive oversight about Iraq reconstruction, which I hope will help pave the way for the continuous improvement of this important endeavor.

I look forward to hearing your views on our oversight and responding to your questions.

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Mr. SHAYS. Thank you.

Mr. Reed, before you begin I just want to acknowledge the presence of Mr. Ruppersberger. We appreciate his presence.

Mr. Reed.

STATEMENT OF WILLIAM REED

Mr. REED. Mr. Chairman, members of the subcommittee, my name is William H. Reed. I am the director of the Defense Contract Audit Agency. My statement this morning will center on the Defense Contract Audit Agency's oversight of Iraq reconstruction and rehabilitation contracts funded from the Development Fund for Iraq. Generally DCAA's services include professional advice and audit assistance to acquisition officials related to the negotiation, award, administration, and settlement of contracts. These services are available upon request from contracting officers to enable them to negotiate a fair and reasonable contract price or are routinely performed by DCAA where required to approve interim payments and assure compliance with other contract terms.

In performing our audits, DCAA has made no distinction between DFI-funded contracts and contracts funded from Defense Department appropriations. In this capacity, we have performed audits on large DFI-funded programs which include Restore Iraqi Oil [RIO], and Restore Iraqi Electricity [RIE].

DCAA is currently responsible for providing contract audit services at 14 contractors holding DFI-funded contracts valued at $3 billion. These audit services include forward pricing proposals, interim reviews of contract payment, and adequacy of internal controls in business systems, as well as compliance with acquisition regulations and contract terms. In addition, flexibly priced DFI contracts and task orders will be included in DCAA's annual review of contractor incurred cost audits.

Most audits have found only minor cost exceptions or deficiencies in systems or processes. In instances where significant issues were identified, the majority of these problems have already been resolved or are being actively worked by contractors. The most significant audit findings by DCAA have occurred on the Halliburton-Kellogg, Brown and Root RIO contract. The RIO contract is made up of 10 task orders currently valued at $2½ billion. Of the 10 RIO task orders, 6 include DFI funding. KBR was authorized to begin work on all of these orders under not-to-exceed-ceiling prices, subject to their subsequent submission of detailed proposals for purposes of negotiating specific task order prices.

DCAA found that most of the KBR task order proposals ultimately submitted for this purpose were inadequate to negotiate a fair and reasonable price due to estimating and accounting deficiencies. In such cases, DCAA consulted with the U.S. Army Corps of Engineers [USACE], and was asked to proceed with the audits while the contractor attempted to correct the deficiencies and prepare a revised proposal. This led to multiple revised proposals and audit reports on the same task orders.

At this time, DCAA has issued a total of 24 pricing reports on RIO task orders, including nine audits of revised proposals to support USACE negotiation of specific prices. This process is sometimes referred to as price definitization.

Three of the task orders have been definitized. During a review, the remaining seven task orders, valued at $2.4 billion, we questioned costs totaling $205.2 million. Of the $205.2 million questioned, $171 million relates to questioned fuel cost. DCAA questioned $139 million due to KBR's failure to support the reasonableness of prices paid for fuel and transportation from a Kuwaiti supplier. In making this determination, we used prices negotiated by the Defense Energy Support Center as a benchmark to assess the reasonableness of the proposed KBR cost.

DCAA also questioned $32 million because KBR inappropriately adjusted fixed prices for fuel purchased from a Turkish supplier on a retroactive basis.

We are working closely with USACE to provide audit and negotiation support on these undefinitized task orders.

In closing, I want to underscore that DCAA is an integral part of the oversight and management controls instituted by DOD to ensure integrity and regulatory compliance in Iraq reconstruction contracting. We work closely with all U.S. procurement and contract administration organizations to not only identify contract pricing or cost issues but to assist them in recovering any excess charges. Sources of the funds obligated on contracts are determined by the contracting organization and transparent to DCAA in carrying out its responsibilities.

I look forward to addressing whatever questions you may have for me. Thank you.

[The prepared statement of Mr. Reed follows:]

Statement of Mr. William H. Reed
Director, Defense Contract Audit Agency
House Subcommittee on National Security, Emerging Threats, and International Relations
June 21, 2005

Mr. Chairman, members of the Subcommittee, my statement for this hearing will center on the Defense Contract Audit Agency's (DCAA) oversight of Iraq reconstruction and rehabilitation contracts funded from the Development Fund for Iraq (DFI).

DCAA Services on DFI Contracts

DCAA's services include professional advice and audit assistance to acquisition officials related to the negotiation, award, administration, and settlement of contracts. These services are available upon request from contracting officers to enable them to negotiate a fair and reasonable contract price or are routinely performed by DCAA where required to approve interim payments and ensure compliance with other contract terms. In performing our audits, DCAA has made no distinction between DFI-funded contracts and contracts funded from Defense Department appropriations. In this capacity we have performed audits on large DFI-funded programs, which include Restore Iraqi Oil (RIO) and Restore Iraqi Electricity (RIE).

Results of Audits

DCAA currently is responsible for providing contract audit services at 14 contractors holding DFI-funded contracts valued at $3 billion. These audit services include forward pricing proposals, interim reviews of contract payment, and adequacy of internal controls and business systems, as well as compliance with acquisition regulations and contract terms. In addition, flexibly-priced DFI contracts and task orders will be included in DCAA's annual review of the contractor-incurred costs.

Most audits have found only minor cost exceptions or deficiencies in systems or processes. In instances where significant issues were identified, the majority of these problems have already been resolved or are actively being worked by contractors. For example, during a review of purchase orders under the RIE contract performed by Fluor Federal Services, DCAA determined that Fluor had negotiated $25 million for work that was no longer needed. Fluor responded quickly to the combined efforts of the DCAA and the U.S. Army Corps of Engineers (USACE) to delete this effort and related profit of $2.3 million.

In another example, DCAA worked very closely with USACE and Perini Corporation to address deficiencies in Perini's purchasing and subcontracting systems. Perini's RIE contract included subcontract costs of approximately 80 percent of the total contract value, making their purchasing and subcontracting systems especially significant. DCAA reviews disclosed several deficiencies relating to Perini's purchasing and subcontracting system, including lack of cost or pricing data analysis of subcontract awards and outdated policies and procedures that did not address the requirements of the Federal Acquisition Regulations (FAR). DCAA and USACE worked closely with Perini to address the deficiencies and reduce the potential for overpayments. DCAA's follow-up review tested both the adequacy of Perini's policies and their compliance with FAR and found that all the deficiencies had been corrected.

Audit Findings on the RIO Contract

The most significant audit findings by DCAA have occurred on the Halliburton – Kellogg, Brown and Root (KBR) RIO contract. The RIO contract is made up of 10 task orders currently valued at $2.5 billion. Of the 10 RIO task orders, 6 include DFI funding. KBR was authorized to begin work on all of these orders under not-to-exceed ceiling prices;

subject to their subsequent submission of detailed proposals for purposes of negotiating specific task order prices. DCAA found that most of the KBR task order proposals submitted for this purpose were inadequate to negotiate a fair and reasonable price due to estimating and accounting deficiencies. In such cases, DCAA consulted with USACE and was asked to proceed with the audits while the contractor attempted to correct the deficiencies and prepare a revised proposal. This led to multiple revised proposals and audit reports on the same task orders.

DCAA has issued a total of 20 forward pricing reports on RIO task orders, including 9 audits of revised proposals to support USACE negotiation of specific prices (sometimes referred to as price definitization). Three of the task orders have been definitized. During our review of the remaining seven task orders valued at $2.4 billion, we questioned costs totaling $205.2 million.

Of the $205.2 million questioned, $171 million relates to questioned fuel costs. DCAA questioned $139 million due to KBR's failure to support the reasonableness of prices paid for fuel and transportation from a Kuwaiti supplier. In making this determination we used prices negotiated by the Defense Energy Support Center as a benchmark to assess the reasonableness of the proposed KBR costs. DCAA also questioned $32 million because KBR inappropriately adjusted fixed prices for fuel purchased from a Turkish supplier on a retroactive basis.

DCAA is working closely with the USACE to provide audit and negotiation support on these undefinitized task orders.

Closing

In closing, I want to underscore that DCAA is an integral part of the oversight and management controls instituted by DoD to ensure integrity and regulatory compliance in I raq reconstruction contracting. We work closely with all U.S procurement and contract administration organizations to not only identify contract pricing or cost issues, but to assist them in recovering any excess charges. Sources of the funds obligated on contracts are determined by the contracting organization and transparent to DCAA in carrying out its responsibilities. I look forward to addressing whatever questions or comments you have. Thank you.

Mr. SHAYS. Thank you, Mr. Reed.
Colonel DuBose.

STATEMENT OF COLONEL EMMETT H. DUBOSE, JR.

Colonel DUBOSE. Mr. Chairman and distinguished members of the subcommittee, good morning. I am Colonel Emmett DuBose and I currently serve as the Deputy Commander of the Southwestern Division, U.S. Army Corps of Engineers out of Dallas, TX. Prior to this assignment, I was stationed in Iraq from October 2003 through June 2004, where I served as the second task force commander and then director of the Corps' Restore Iraqi Oil [RIO], program. My mission there was to work cooperatively with the Iraqi people to safely and effectively restore the oil infrastructure of Iraq to enable the economic recovery of Iraq.

I have been asked to review with you today the DCAA audits of the DFI-funded task orders which are part of the KBR RIO contract which was physically completed last year.

The KBR RIO contract consists of 10 task orders, and the funding for this involved both U.S. and Iraqi sources. Four of the task orders were funded using U.S. appropriated funds and six using DFI funds. Since this is a cost plus award fee contract, It requires the DCAA audits as an integral part of the contract quality control and cost definitization process in which we are now engaged.

At the request of the contracting officer, DCAA has completed 20 audits and is actively working on several others. Fifteen of these audits have been in support of DFI-funded task orders. This is a part of an iteractive process involving the efforts of the auditors, the contracting officer, and the contractor focused on protecting the public interest, both United States and Iraqi, while providing a fair and equitable task order settlement.

Five of the six DFI-funded task orders were established to meet emergency humanitarian fuel requirements by importing refined petroleum products. The urgency, magnitude, complexity, and hazardous conditions under which these task orders were performed is unprecedented. These factors are reflected in the fact that there have been multiple revisions of the KBR proposals resulting in multiple revisions of the DCAA audits.

In this iterative process, we have had 14 DCAA audits, 9 of which have been superseded by revised audits, which leaves 1 audit for each of the five fuel task orders. These audits, to include all questioned costs, are being used by the contracting officer in conjunction with the government's contracts performance information and the contractor's proposals to establish the government's position, from which the contracting officer will negotiate final payment and determine the award fee. In the meantime, the government is currently withholding approximately $68 million in payments plus all possible award fees pending settlement of this task order.

The other DFI task order is No. 6. It involved three things: First, the design and construction of multiple pipeline crossings of the Tigris River; second, power generation stations which were used to run various oil production, distribution, and refinery facilities across Iraq; and, third, we supply equipment, construction materials, and technical services which were required by the oil min-

istry's own construction crews so that they could construct and build a 40-inch diameter pipeline from the oil fields in Kirkuk to Baiji. DCAA has completed one audit of this effort and has what we believe to be the final audit now underway. We expect to complete the audit by July, after which the contracting officer will definitize the task order and negotiate final payment.

In summary, it is expected that in a contract of this magnitude and complexity DCAA will continue to question some costs. As we have seen in this case, questioned costs usually decrease as the contractor revises his proposals and responds to the DCAA audits. The resulting final audits are then used by the contracting officer to definitize and negotiate the task order payments and determine award fees.

It is important to note here that DCAA does not question whether KBR actually incurred any of these costs; rather, DCAA auditors have questioned primarily whether KBR may have been able to obtain some services at a lower price than which KBR has acquired them.

These questioned costs will ultimately be resolved by the contracting officer based on input from DCAA, DCMA, and others as appropriate. Our job now is to use this information, the information at our disposal, to assist the contracting officer in reaching a fair and equitable settlement of these task orders with the contractor while fully protecting the public interest of the United States and Iraqi people.

Sir, this concludes my prepared statements. I would be happy to answer your questions.

[The prepared statement of Colonel DuBose follows:]

STATEMENT BY

Colonel Emmett H. Du Bose, Jr.
Deputy Commander
U.S. Army Corps of Engineers, Southwestern Division

BEFORE THE
HOUSE GOVERNMENT REFORM COMMITTEE,
SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS, AND
INTERNATIONAL RELATIONS

"*THE DEVELOPMENT FUND FOR IRAQ*"

FIRST SESSION, 109TH CONGRESS
JUNE 21, 2005

Introduction

Good morning. I am COL Emmett Du Bose. I currently serve as the Deputy Commander of the Southwestern Division, U.S. Army Corps of Engineers (USACE), in Dallas, Texas. Prior to this assignment, I was stationed in Iraq from October 2003 through June 2004 and served as the Second Task Force Commander and Director of the "Restore Iraqi Oil" or RIO Program. My primary assigned mission was to work cooperatively with the Iraqi people to safely and effectively restore the oil infrastructure of Iraq to enable the economic recovery of Iraq.

Funding for this effort involved both US and Iraqi sources, to include the Development Fund for Iraq, or DFI. DFI-funds were used for both infrastructure restoration services and the importation of refined fuels under the original Corps RIO contract. I have been asked to review with you today the status of DCAA audit reports on the DFI-funded task orders for that contract.

Overview of KBRS-RIO Contract

The RIO contract, which was physically completed last year, is a cost reimbursement contract consisting of 10 task orders (T.O.s). Two U.S.-funded T.O.s are also fiscally complete (1 and 2) and another U.S.-funded T.O. is fiscally complete, pending claim resolution (4). The remaining seven T.O.s, to include the six DFI-funded T.O.s, are still in the definitization process (3 and 5-10).

Since this is a cost-plus award fee contract, it requires Defense Contract Audit Agency (DCAA) audits as an integral part of the contract definitization process in which we are now engaged. At the request of the Contracting officer, DCAA has completed 20 audit reports, and is actively working on several others, in support of this effort. Fifteen of these audit reports have been in support of DFI-funded task orders. The Contracting Officer is using the information provided by DCAA, along with information from USACE

field representatives and advisors to complete remaining negotiations and make award fee determinations.

Task Orders (T.O.) #5, 7, 8, 9 and 10

Five of the six DFI-funded T.O.s were issued to meet emergency humanitarian fuel requirements by importing refined petroleum products. It became clear to USACE that we would be assigned the task of importing and distributing humanitarian fuel products on 17 April 2003. At that time, there were serious shortages of refined petroleum products. Gasoline lines stretched for long distances in Baghdad. To keep order in these lines, soldiers had to leave their armored vehicles. One soldier recently had been killed attempting to keep order. There was high level concern about the volatile situation the shortages were creating.

Task Force RIO believed that any humanitarian fuel mission should be given to USAID. Alternatively, Defense Energy Support Command (DESC), LOGCAP contract or Combined Forces Land Component Command of Central Command (CFLCC) Logistics already were used to provide similar logistics functions for the military. All seemed better suited to fulfill this requirement than the Task Force RIO, which, despite the broad scope of the original RIO contract was principally established to provide engineering services for oil infrastructure restoration. We understand DESC, LOGCAP and CFLCC Logistics also took the position that the import and distribution of humanitarian fuels were not part of their mission.

Task Force RIO was concerned that executing this fuel importation mission would detract from its ability to focus on the repair and restoration of the petroleum infrastructure (which it did), and that the use of funds allocated for this purpose would divert the funding necessary for oil infrastructure restoration.

On or about 4 May 2003, CFLCC issued an order tasking RIO to execute this mission. Discussions regarding statutory and contractual authorities for use of the RIO contract

to perform the mission and how it could be funded followed. Eventually, all concluded that the requisite authority was available and the Coalition Provisional Authority (CPA) determined that DFI funds would be used for the mission. On 4 May 2003, CFLCC officially assigned Task Force RIO the first humanitarian fuel mission. The contracting officer immediately issued a task order to KBRS requiring the import and distribution of humanitarian fuels. Once assigned this mission, the RIO team did its best to execute the mission successfully.

Task Force RIO received funding for this contract in increments as it became available. There were 15 changes in funding in the first three months of the mission alone. Over the life of the mission, RIO received more than 30 days of funding only 4 times (31, 36, 41, and 68 days). On three occasions, RIO received only 2 days of funding. On four of the occasions when larger amounts of funds were received, some of those funds were later revoked. Consequently the costs of executing this fuel mission were higher than they would have been if USACE had been provided sufficient funds to direct the contractor to enter into longer term purchases of fuel.

In December 2003, the DESC was directed by DoD to begin planning efforts to assume the humanitarian fuel mission. This mission was formally transferred to DESC on 1 April 2004. DESC, unlike RIO, had several months to plan its procurement. In addition, it received sufficient funds up front to contract for 90 days for fuel purchases and deliveries. These were significant factors in the different pricing DESC was able to achieve when it assumed responsibility for the mission.

The urgency, magnitude, complexity and hazardous conditions under which the RIO task orders were performed is unprecedented. These were contributing factors which, along with KBRS estimating system challenges, led to the multiple revisions of KBR proposals and resulting multiple revisions of DCAA audit reports. All together, there have been 14 DCAA audit reports on these fuel T.O.s, nine of which have been superseded. The DCAA audit reports, to include all questioned costs, are being used by the contracting officer, in conjunction with the Government's contract performance

information and the contractor's proposals, to establish the Government's position, from which the contracting officer will negotiate final payment on the various task orders and determine the award fee. We are currently in the middle of this process and intend to finalize the effort before the end of summer. In the meantime, the Government is currently withholding payments of approximately $68 million, plus all possible award fees, pending settlement of these T.O. payments.

T.O. #6

The other DFI-funded T.O. is #6. It involved the design and construction of multiple pipeline crossings of the Tigris River at Al Fatah, near Bayji, as well as multiple power generation stations required to support the operation of oil production, distribution and refineries across Iraq. It also required KBR to provide equipment, supplies and technical services to support the Iraqi Oil Ministry's efforts to build a 40-inch diameter pipeline from Kirkuk to Bayji.

DCAA has already completed one audit report on this effort and is now working on what we believe will be the final T.O. 6 audit report. We expect the final audit report to be completed by July, after which the contracting officer will definitize the task order and negotiate final payment with the contractor.

Use of DCAA Audit Reports

The audit process on this cost contract has been iterative. When the contractor submits a revised proposal, the revision is audited by DCAA. As part of this process, the contractor, contracting officer and other advisors provide frequent updates and additional information that often leads to modifications of the original draft audit report. For example, an early DCAA audit report of a KBRS fuel T.O. identified a $27 million of costs for the transportation of liquid petroleum gas, or LPG. Based on a comparison of transportation costs and the quantity of LPG on a specific task order, the transportation costs appeared to be unreasonable, given the small amount of LPG product shown on the task order. When the audit report was reviewed by KBRS, they found that the bulk

of LPG product that had been transported was actually accounted for under a different task order. As a result, the $27 million in questioned cost was resolved.

DCAA Questioned Costs

In a cost contract of this magnitude and complexity we expect there to be questioned or unsupported costs in audit reports. So it is not surprising that DCAA questioned certain costs of DFI-funded T.O.s. In its final audit reports, we expect that DCAA will continue to question certain costs on the DFI-funded T.O.s. Moreover, it is important to understand that DCAA does not question whether KBRS actually incurred any of these costs; instead, DCAA questions primarily whether KBRS might have been able to obtain some services at a lower cost than they acquired them. Some of the questioned costs addressed in previous audit reports have now been resolved, resulting from changes in the KBRS proposals or by additional information provided by KBRS. As usual in large cost contracts, we expect some cost issues will remain, even after the adjustments DCAA has made to its final audit reports. Also, as usual, the contracting officer is responsible for resolving those issues.

In making his decisions, the contracting officer carefully weighs the advice provided by DCAA, contracting personnel and other advisors appropriate for the circumstances, such as DCMA. The contracting officer fully considers the advice of DCAA, just as he considers the advice of these other advisors. The final decision on the weight to be given to any advice depends on the contracting officer's evaluation of that advice.

Redacted KBRS Audit Reports

USACE officials received a request to provide audit reports of sole-source DFI-funded contracts to the International Advisory and Monitoring Board (IAMB). The Office of Chief Counsel was consulted due to concerns about the release of proprietary data outside official U.S. government channels. When Office of Chief Counsel advised that USACE could not release confidential commercial information to sources outside the

U.S. government without contractor consent, USACE officials asked KBRS if they would agree to releasing the audit reports to the IAMB. KBRS informed USACE that they would not agree to provide the audit reports, asserting that the audits contained their proprietary information and that the government was prohibited from releasing that information under the Trade Secrets Act. USACE Office of Chief Counsel advised that unredacted audits could not be released to the IAMB without contractor consent. The USACE Office of Chief Counsel coordinated with the DoD Office of General Counsel in providing this advice.

Recognizing that we could not provide the IAMB unredacted audit reports, we sought a method to provide as much information to the IAMB as possible. Accordingly, we requested that KBRS review the DFI-funded T.O. audit reports and redact information they believed was protected under the Trade Secrets Act. KBRS provided USACE with redacted audit reports and a letter authorizing USACE to release the redacted audit reports to the IAMB. Counsel noted that there were significant legal risks, to include potential individual criminal violations, associated with changing the redactions provided by KBRS.

USACE and DoD personnel delivered the redacted copies of the KBRS DFI audit reports on five of the six task orders to the IAMB in New York in October 2004. The audit report of the sixth task order was not complete at that time, but was delivered soon thereafter. No requests to provide additional information to the IAMB have been tasked to USACE since that time.

Summary

Six Task Orders on the RIO contract were funded with DFI funds. Five involved fuel import and distribution. There have been a total of 14 audit reports and additional advice from DCAA on these task orders. One involved repairs to the Iraqi oil infrastructure. There has been one audit reports with one additional audit report pending on this task order.

Some costs that have been questioned or found to be unsupported in previous audit reports have been resolved, either by changes in the KBRS proposals or by additional information provided to the auditors. We fully expect that, although there is no question concerning whether or not KBRS actually incurred these costs, DCAA audit reports will continue to question KBRS business judgment in incurring some of these costs. These questions will be resolved by the contracting officer in the near future, based on input from DCAA, DCMA and other advisors as appropriate. The job now is to use the information at our disposal to assist the contracting officer in reaching a fair and equitable settlement of these task orders with the contractor, while fully protecting the public interest.

Mr. SHAYS. Thank you.

Mr. Benkert, it is my understanding that you do not have a prepared statement; is that correct?

Mr. BENKERT. Mr. Chairman, that is correct.

Mr. SHAYS. OK.

STATEMENT OF JOSEPH BENKERT

Mr. BENKERT. I am, as you said, Joseph Benkert. I am the Deputy Director of the Defense Reconstruction Support Office in the Office of the Secretary of Defense. Relevant to this hearing, our office, as the successor office to the CPA's Washington office, provided, on behalf of OSD, the management comments on the Special Inspector General for Iraq Reconstruction's audit of funds provided to Iraqi ministries that Mr. Bowen testified about, that set of management comments which accompanied a detailed set of comments from Ambassador Bremer included in the audit report.

I am also, since about December of last year, the DOD's liaison to the International Advisory and Monitoring Board, and attend meetings of the International Advisory and Monitoring Board as a U.S. observer.

I am prepared to answer questions.

Mr. SHAYS. OK.

Mr. Norquist, it is my understanding you do not have a statement; is that correct?

STATEMENT OF DAVID NORQUIST

Mr. NORQUIST. That is correct, Mr. Chairman.

Mr. SHAYS. Before I begin my questioning, I just want to ask why. Why, Mr. Benkert, do not you have a statement? Why, Mr. Norquist, do you not have a statement?

Mr. NORQUIST. I'd be happy to answer that, Mr. Chairman, and I regret that there was this problem.

I learned last week that I would be the witness, and I learned, regretfully, too late for me to get testimony written and cleared. It was my understanding that the subcommittee was going to be consulted on this, but I did not find out until last night that had not happened, and I regret that.

Mr. SHAYS. But what I do not understand, Mr. Norquist, is that you could have at least written your statement and then the pressure would have been on someone else, OMB, to have approved it. But why did not you at least write your statement? You had at least a week to do that.

Mr. NORQUIST. I did not have a week to do that, sir. I asked whether or not it would be able to be done and cleared in time and was simply advised that would not happen. I apologize for that, though.

Mr. SHAYS. Well, you know, they have put you in a bad situation.

Mr. Benkert, am I pronouncing your name correctly, sir?

Mr. BENKERT. That is correct, sir.

My answer is the same as Mr. Norquist's, Mr. Chairman. I learned late last week that I would be the witness. And I apologize for not having a statement and regret not having done so, but my understanding was that this information had been communicated

to your staff and that there had been discussions along these lines, and I regret it if this was a surprise to you.

Mr. SHAYS. No, it is not a surprise that you do not have a statement because they told me last night you would not have a statement; it was a surprise yesterday that you did not have a statement.

My predecessor on this subcommittee, the previous chairman, was the Speaker of the House. I just wonder if you would have done that to his subcommittee as you have done it to ours.

We are grateful both of you are here. We wrote on June 9th requesting that Ms. Tina Jonas, Under Secretary of Defense, Comptroller, and Chief Financial Officer, appear, and Mr. Howard Burris, Director of Defense Support Office [DSO], Iraq and Afghanistan, Office of Secretary of Defense. You both are better witnesses in terms of your knowledge than they are, so we appreciate who they sent.

We think DOD has done you a disservice in not helping and encouraging you to write a statement and have it approved and, frankly, I think it just adds to our lack of confidence and our feeling that there is something to hide when I do not think there is something to hide.

I will begin my questions.

Mr. Norquist, describe in detail the process DOD followed in providing redacted DCAA audits to the IAMB, the U.N.

Mr. NORQUIST. Yes, sir. The IAMB requested copies of audit reports of sole source contracts paid for using DFI funds. The audit reports for the six DFI-funded task orders on this contract were completed by DCAA between August and October 2004. Since the authority to release DCAA audits rests with the contracting officer, we asked if the Corps would provide the reports to the IAMB. My understanding is the Corps consulted with the contracting officer, who was the deciding official for the releasability of the reports.

At this point I would like to turn it over to Colonel DuBose, who can explain how the Corps handled this portion of the process.

Colonel DUBOSE. Mr. Chairman, USACE officials received a request to provide the audit reports of sole source DFI-funded contracts to the IAMB. The Office of Chief Counsel was consulted due to concerns about the release of proprietary data outside of official U.S. Government channels. The Office of Chief Counsel was advised that USACE could not release confidential commercial information to sources outside the U.S. Government without contractor consent. USACE officials asked KBR if they would agree to release the audit reports to IAMB.

KBR then informed USACE that they would not agree to provide the audit reports, asserting that the audits contained their proprietary information and that the Government was prohibited from releasing that information under the Trade Secrets Act.

USACE's Office of Chief Counsel advised that redacted audits could not be released to the IAMB without contractor consent. The USACE Office of Chief Counsel coordinated this with DOD Office of General Counsel and provided this advice.

Recognizing that we could not provide the IAMB unredacted audits, we sought a method to provide as much information to the IAMB as possible. Accordingly, we requested that KBR review the

DFI-funded task orders and the audit reports and redact information that they believed was protected under the Trade Secrets Act. KBR provided USACE with the redacted audit reports and a letter authorizing USACE to release the redacted audit reports to the IAMB.

USACE officials and counsel noted that there were significant legal risks to include potential individual criminal violations associated with changing the redactions provided by KBR.

Mr. SHAYS. Would either or both of you describe to me how this is a transparent process? How is the U.N. basically able to determine what is happening with these dollars with so much redaction, Mr. Norquist?

Mr. NORQUIST. Sir, it was our intent to see that the IAMB received as full an answer as possible consistent with the law. With that premise, as I recall, we first asked if they could be provided unredacted reports. When we understood that they could not, we asked if the redactions could be less so the information provided could be more. We then followed up and suggested would it be possible to provide the unredacted to a third party. Since it appeared we'd only be able to provide the Corps the redacted, we looked into the option of a—we were advised if it was a contract with the U.S. Government we could hire an auditor of some other firm, give them the complete, unredacted, and let them report to the IAMB as to the contents. That contracting process occurred after my involvement with the IAMB, which ended about October.

But the effort here, sir, was to take it as far as we could to provide as full answer as possible and then to try and provide the IAMB with an additional means of having some assurance as to the nature of those documents.

At this point I think—I do not know if anyone else wants to add to that.

Mr. SHAYS. So basically no one has been given an unredacted version?

Mr. BENKERT. If I could just add to that, Mr. Chairman, as Mr. Norquist mentioned, I think as you know, the IAMB—to try to answer your question about transparency with the IAMB, in addition to a specific request for these audits, the IAMB requested that an audit be—a special audit be undertaken of all sole source contracts funded from the DFI, that is, to try to get a picture of all sole source contracts which might have been funded from the DFI and what other audits may have been out there, as well.

The IAMB made this request to the CPA in June of last year just prior to the CPA being disestablished, on the theory that the CPA would commission such an audit using DFI funds. When the CPA went away, the IAMB looked to the Iraqi government to commission such an audit on the theory that the Iraqi government was now responsible for the DFI from the point of the transition on June 28th.

As Mr. Norquist said, in the process of trying to provide the specific audits that the IAMB had requested, it became apparent that if the Iraqi government were to commission an audit of sole source contracts, that the Iraqi government, because the auditor would work for them, might have similar problems in gaining access to proprietary information, in any case would have practical difficul-

ties of being able to do this audit because the information they would need to get is in various places, including in the United States.

At that point we offered to the IAMB to commission—that is, the Department of Defense—to commission this special audit of sole source contracts because if we did so the auditor working for us would have no issues of his ability to gain access to unredacted audits and any other government information.

So we agreed to a statement of work with the IAMB. We reported this information to the International Advisory and Monitoring Board at the same meeting of the International Advisory and Monitoring Board where Mr. Norquist delivered the redacted audits, so that the IAMB knew that we were taking actions to commission this audit which would have access to all the unredacted information.

We agreed with the IAMB in December on a statement of work for this audit and we have contracted with a firm to do this audit on April 15th, and so this audit is now in progress. This is all known to the IAMB.

Mr. SHAYS. I thank the gentleman.

I have taken 7 minutes, so every Member here will have 7 minutes to start, and we will have a second round.

Mr. Kucinich.

Mr. KUCINICH. All right, Mr. Chairman. If it please the Chair, I would like to defer to our ranking member for the full committee, Mr. Waxman.

Mr. SHAYS. Thank you. Before the gentleman begins, I just would welcome Mrs. Maloney and Mr. Sanders here. Thank you.

Mr. WAXMAN. I want to thank my colleague, Mr. Kucinich, for allowing me to go first, and thank you, Mr. Chairman, for recognizing me.

Mr. Bowen, I want to thank you also for testifying today. Congress created your position so that we would have a professional auditor reporting directly to us on the billions of dollars being spent in Iraq, and you have done your job professionally and responsibly, even when your conclusions have been uncomfortable ones, and that is exactly what an IG should do. I understand this is your first appearance before Congress. I commend the chairman for giving you this long-time overdue invitation and I commend you for being here.

As I mentioned in my opening statement, the CPA shipped nearly $12 billion in cash from the United States during its term in Iraq. It is hard for people to conceptualize that much money, so I tried to put it in real terms—19,000 cash packs, 484 pallets, 107 million $100 bills. You might think that with this amount of money in cash there would be established strict procedures on controlling the physical access to this cash, as well as strong accounting mechanisms to ensure that it was used for intended purposes, but you found just the opposite. You found "physical security was inadequate. The CPA did not establish or implement sufficient managerial, financial, and contractual controls." You found that DFI funds were susceptible to waste, fraud, and abuse.

As a result, you also concluded that the CPA violated the Security Council requirement for transparency set forth in Resolution 1483.

I want to ask you a little bit about some of these conclusions.

First, in your July 28, 2004, report on DFI cash controls, you concluded physical security safeguards were inadequate. For example, you found CPA comptroller did not have adequate control or access to their field safe. Can you tell us more about that?

Mr. BOWEN. Yes, sir. Thank you.

This was an audit of really the operational security of the comptroller's practices and procedures. Interestingly, their office was right next to the IG office at that time in the palace there on the Tigris, and I assigned two of my top auditors to get in there because of the issues you have alluded to, and that is the cash environment that we were operating in raised natural concerns.

There were issues connected with management of the safe, securing the keys to those safes, and general procedures connected with cash security.

We brought those to the comptroller's attention and they changed the way they did business as a result. I am confident that since then there are proper security measures in place in the palace because, frankly, the environment has not changed that much with respect to cash. It is still a cash economy. It is still a cash operation for the most part. Electronic funds transfer is still an idea in Iraq, an idea whose time is closer and closer to coming.

But to answer your question, I think that our audit helped tighten the ship on that issue.

Mr. WAXMAN. Before that they had cash in safes and lots of different people had access to it? Is that the——

Mr. BOWEN. That is correct.

Mr. WAXMAN. OK. You also found that CPA did not have adequate accounting procedures for this cash once it was in their possession. For instance, you reported that CPA did not follow its own regulation requiring an independent certified public accounting firm to monitor DFI spending. Can you tell us about that?

Mr. BOWEN. Yes. CPA regulation required the CPA to hire a certified public accounting agency to provide an internal audit function. A company called Northstar was hired to meet that requirement. Their mission changed after their hiring. The comptroller at the time sought to use them more to help him manage the accounting aspects of management of the DFI, thus, the internal audit function was superseded by a more direct ledger sheet accounting process just simply to keep up with the mammoth task of keeping track of the DFI.

Mr. WAXMAN. By far the largest disbursements were made to Iraqi ministries. You issued a report on that, and you found that when the United States took control of Baghdad there was "no functioning Iraqi government, no experience within the Ministry of Finance in managing the national budget, no budget or personnel records, and the payroll systems were corrupted by cronyism and ad hoc fixes."

Despite all these glaring deficiencies, the CPA transferred more than $8.8 billion to these ministries without any followup to make sure these funds were spent properly. This sounds to me like a per-

fect recipe for waste and potentially for fraud. In your opinion, how likely is it that some of the ministry funds were skimmed, stolen, paid to non-employees, or paid to fake employees and ghost employees? Were these real risks?

Mr. BOWEN. They were real risks and we reported them in our audit. Let me be clear about the scope of our audit. At the time I was the Coalition Provisional Authority's IG, which meant I was overseeing the plans and programs of the Coalition Provisional Authority. That included perhaps their most significant program, management of the DFI, which was underscored by the core purpose of standing up a new Iraqi government and helping it function. That required the funds, namely the DFI, to make that happen.

We looked at how the CPA structured itself to accomplish that goal, and in looking at that we—in interviewing nine senior advisors of the 26 ministries, interviewing a number of personnel, and reviewing every document we could come across, we ran across these other issues that we reported in our audit, namely the issues you alluded to about the paying of ghost employees.

I think the response to that was it was necessary to make those payments to preserve the peace, but I think that the reality of the situation——

Mr. WAXMAN. In other words, they were handing out money because they thought that would calm things down. They were not really sure who was getting the money. It was risk of all this money being dissipated improperly, but that was a risk they decided to take?

Mr. BOWEN. In that instance, yes, with respect to that issue.

Mr. WAXMAN. This is not the only evidence of waste, fraud, and abuse. Your office also found that millions of dollars in DFI funds given to commanders simply went missing. An audit by KPMG found hundreds of thousands of DFI funds missing from one division's vaults, and Defense Department audits have identified hundreds of millions of dollars in overcharges by contractors to the DFI.

The bottom line is that there were multiple deficiencies at every stage in this process, from the point at which the cash arrived in Baghdad to the point at which it left the hands of CPA officials. It seems to me that CPA was ill prepared for this responsibility and, frankly, it appears that the administration was making up policies and procedures as it went along. Do you think that is an unfair statement?

Mr. BOWEN. This was an enormously challenging situation to stand up from destruction a new Iraqi government, to help begin the reconstruction of a nation, both structurally within its government and structurally as part of its infrastructure.

I know—I was there—that the personnel within CPA worked around the clock 7 days a week, and for the most part, by my own observation, were well-intentioned. Inevitably in such an environment, with so much cash and such an enormous task and limited resources—personnel was a big issue—there were inefficiencies, and we found them.

As I said when I started this job, we will let our audits and our investigations speak for themselves, and they have. But we have

investigations going on with respect to fraud that you alluded to, but our audits point primarily to inefficiencies. Could things have been done better? Yes. Do we have some significant lessons learned out of this? Yes. Is my organization pursuing, accumulating all those lessons learned? Yes. We have a very ambitious enterprise that we are going to push into next year that is going to look at personnel, program, planning, acquisition, and contracting with the experts who are there. We have already done hundreds of interviews, we have accumulated a lot of information, and at the end of the day we will encapsulate this story in that report.

Mr. WAXMAN. Thank you.

Thank you, Mr. Chairman.

Mr. SHAYS. I thank the gentleman.

At this time the Chair would recognize Mr. Turner for questions for 7 minutes.

Mr. TURNER. Thank you. Mr. Chairman, I just want to begin by echoing what I had indicated in my opening statement of just my admiration of this chairman and his efforts in oversight and making certain that, both on the issue of terrorism and in the issue of Iraq, that we have appropriate information and appropriate support and oversight for the important functions of our Government. As we talk about the democratization of Iraq, we have to be very mindful of the issue of the role of Congress and its role of oversight.

I have some questions about the issues of the redaction of information and the relationship to this committee.

I have just been conferring with the Congressional Research Service staff that is being provided to us, regarding the applicable laws. Mr. Norquist, you stated something that concerned me greatly.

In talking about the issue of the ability to provide the necessary information for transparency, you talked about operating within applicable laws. Many times in my 10 years now in dealing with Government bureaucracies I have found that many times when we get the answer of "going with applicable laws in order to comply with what we know is a requirement," that sometimes it is a result of lack of foresight of the individual having the responsibility for commencing an action.

For example, it appears that you find yourself in a situation—we found ourselves in a situation of how do we provide redacted information and the contractor's rights and abilities to prevent that disclosure. I have been provided with provision of the U.S. Code, Section 423, that talks about not knowingly providing proposal information, source selection information, and other restrictions on providing information.

I want to note that the exceptions that are specifically identified do not include a restriction of providing that information to Congress. Expressly it says that information can be provided to Congress, meaning that the contractor would have no ability for restricting the ability to provide information that this chairman has been asking for and still does not have, so this law does not apply with respect to providing information to this chairman.

But I want to know to what extent there are or were options when we started this process, in the contract process or in the reg-

ulatory process, because if we accept that we are going to go into a process where we require transparency and our international reputation is on the line, it would seem to me that we would enter that process from the beginning making certain that we have chosen a path that permits us to have transparency.

I'd like Mr. Norquist and Mr. Benkert if you would to please comment on the ability in the beginning of this process to have structured it in a manner that would have given us the transparency we need.

Let's start with Mr. Benkert.

Mr. NORQUIST. Sir, as you pointed out, it was our intent to give them a full answer, and so our initial thought and our initial effort was to try and get them unredacted audits, which would be the most complete answer, and that is what we sought to do.

I cannot speak to the rules and the laws that govern what is or not revisable. I'd defer to the lawyers and to the Corps for the advice that they were given on what was permissible. But at the different stages we asked if more could be done, and it was in part because of the difficulty in doing that we sought other solutions such as providing unredacted to an independent party so that there would be some sense that you do not have to take our word for it.

My intent throughout this process was to ensure that, to the extent possible, that we did that. But I apologize. I cannot speak to the legal provisions that affect this.

Mr. BENKERT. Let me speak to this sole source audit that we have commissioned, this special audit of sole source contracts. In the audit that—to address your issue of dealing with these issues of transparency up front, in the audit we have commissioned we have specifically told the auditor that our intent is for him to produce a report that is going to be handed over to the IAMB. So at the beginning it is clear that his purpose is to provide information that is going to go to the IAMB, so there is no issue down the line of his collecting information which then becomes a problem to hand over because of his not knowing that was the intended purpose rather than the U.S. Government.

I do not know whether a procedure like that could have been applied in the early days of these contracts or not, and I would defer to my colleagues on that.

Mr. TURNER. Does anyone else on the panel have an answer for that?

Colonel DUBOSE. Sir, I would just note that when we started the KBR contract it was with appropriated funds. We really did not know that DFI funds would be applied until around April, May 2003.

Mr. TURNER. I would appreciate it if you guys would pursue getting an answer for the committee on the issue of whether or not the processes that are chosen could have been different that would have removed the impediment.

[The information referred to follows:]

Hearing Date: Jun 21, 2005
Hearing: The Development Fund for Iraq: U.S. Management of Iraq Oil Proceeds and Compliance with U.N. Security Council Resolution 1483.
Member: Congressman Turner
Insert: (Page 71, Line 1509)

(The information follows):

No alternative course of action would have enabled the Department of Defense to provide unredacted copies of the DCAA audit reports to the IAMB. The Trade Secrets Act, title 18, U.S. Code, section 1905, makes it a criminal offense for any officer or employee of the U.S. to disclose certain types of proprietary commercial information, unless authorized by law. The DCAA audit reports at issue in this case include such information. Thus, in the absence of statutory authority to release that information to the IAMB, the information must be withheld, unless the contractor consents to the release of information it considers to be protected. No existing statute permits DoD to release to the IAMB proprietary commercial information that the Trade Secrets Act protects against disclosure. Accordingly, DoD must withhold from the IAMB any information in the DCAA audit reports that the concerned contractors identified as proprietary, except to the extent that the contractors consent to the release of such information.

Mr. TURNER. Mr. Norquist, the very first question that the chairman asked you, you were reading from materials that had been coordinated with the colonel. I am assuming that, although you do not have a prepared statement for us, that you do have some written materials that have been approved for your appearance here today?

Mr. NORQUIST. I do not have a prepared statement or materials that were approved. What I did do is I sat down with the colonel when he had his redacted and I agreed that was my understanding of the process, as well, so I support his prepared statement and his explanation of what happened in the process.

Mr. TURNER. Do you have any objection to providing us copies of the written answers that you have to the questions that were anticipated and asked by the chairman?

Mr. NORQUIST. I do not know of a reason I could not. Let me check. I do not know what the protocols are on this, but I will go back and find out and I will provide what I can.

[The information referred to follows:]

Hearing Date: Jun 21, 2005
Hearing: The Development Fund for Iraq: U.S. Management of Iraq Oil Proceeds and Compliance with U.N. Security Council Resolution 1483.
Member: Congressman Turner
Insert: (Page 72, Line 1528)

(The information follows):

As requested below are the written answers to the two questions the Chairman asked me.

1. The IAMB requested copies of audit reports of sole-sourced contracts paid for using DFI funds.

The audit reports for the six DFI-funded task orders on this contract were completed between August and October of 2004.

Since authority to release DCAA audits rests with the contracting officer, we asked if the Corps would provide the reports to the IAMB.

My understanding is that the Corps consulted with the contracting officer, who is the deciding official for releasability of the reports.

2. It was our intent to see that the IAMB received as full an answer as possible consistent with the law.

As I recall, I asked if the Corps could:

- provide unredacted reports;
- redact less to provide more information; and
- give unredacted reports to another party.

Mr. TURNER. I conferred with our counsel before, the chief of staff of the subcommittee, before asking this question. If you would coordinate with him on that issue, I think it would be helpful and appreciated.

I do not have any other questions.

Mr. SHAYS. Thank you. The Chair would recognize Mr. Kucinich.

Mr. KUCINICH. I thank the Chair.

Mr. Bowen, I would like to explore a little bit more about this cash environment. We know from Mr. Waxman's testimony that the administration transferred from New York to Baghdad more than $281 million individual currency notes on 484 pallets that included more than 107 million $100 bills, and he put up on the screen what the Federal officials called cash packs, pictures of them, and each one of these cash packs contained 16,000 bills. One cash pack with $100 bills is worth $1.6 million, and the Federal Reserve shipped more than 19,000 of these cash packs to Iraq. You agree substantially with that description, correction?

Mr. BOWEN. Yes, I do.

Mr. KUCINICH. OK. Now, let's take a cash pack worth about $1.6 million and let's locate it with someone in Iraq. Explain to me what happened. Put it in somebody's hands and just describe for this committee what would happen. What would they do? How would they distribute the money?

Mr. BOWEN. Sir, there was a safe in the basement of the Republican Palace where the money was kept, and there were a number of those flanks that you described that brought money over that funded the obligation, so to speak, of the Iraqi government, $19 billion, roughly, in the year that the CPA was operating.

Mr. KUCINICH. So somebody would come to wherever the safe was to get their money?

Mr. BOWEN. That was part of how it happened, that is exactly right, but it was through the comptroller. There was a budget, 2003, remainder of 2003 budget, and then a 2004 budget, and then an amended 2004 budget, and that provided monthly allocations to each ministry and——

Mr. KUCINICH. I understand that, but here's what I am trying to get at: would that one location be the only place where the money was distributed from? Or were bundles of money taken to other distribution points, or were bundles of money given to other individuals who would then distribute that cash?

Mr. BOWEN. Now you are getting to a level of detail that I will have to get back to you on. I know that the primary distribution point——

Mr. KUCINICH. May I ask, Mr. Chairman, I appreciate what the scope of your study was, but, Mr. Chairman, it seems to me if we have the IG here saying there were not proper managerial, financial, and contractual controls, I think it would be instructive to this committee to understand exactly how the money was distributed, because then we could come to an understanding of whether or not, you know, it was just simply a lack of controls or whether or not this committee could fairly conclude that money was lost, stolen, or corruptly misused. I mean, is that a fair assumption?

Mr. BOWEN. I would be happy to provide you with that answer.

Mr. KUCINICH. If you would, give it to our counsel——

Mr. BOWEN. Yes.

Mr. KUCINICH [continuing]. And we will make sure it is shared with both majority and minority.

Mr. BOWEN. I will track that down.

Mr. KUCINICH. Thank you. Again, we'd like to know, you know, have you ever interviewed anyone who actually had in their hands bundles of $100 bills and they were distributing? Did you talk to anybody——

Mr. BOWEN. Yes.

Mr. KUCINICH [continuing]. In that capacity?

Mr. BOWEN. Well, we interviewed the comptroller who was responsible for that.

Mr. KUCINICH. But only one person?

Mr. BOWEN. And the other—those in his office that participated in that, and I think you are also alluding to our most recent audit, the April 30th audit regarding the disbursement of DFI cash under the R3P program in south-central Iraq in Hillah. In that more specifically, yes we did interview people who were handling millions of dollars in cash, and we have one very significant audit out on that has serious findings. We have four more that are coming and we have several investigations underway.

Mr. KUCINICH. Who determined whether a private contractor should be paid in cash or in some other form? Who made that determination?

Mr. BOWEN. It was a matter of necessity, and it depended on the nature of the circumstances. There would be no one determination of that. If the private contractor was an Iraqi contractor in country, that contractor was paid in cash. If it is a U.S. contractor, then electronic funds transfer can happen back this side of the world.

Mr. KUCINICH. Were there any cases in which U.S. contractors were paid in cash?

Mr. BOWEN. Yes, there were, but I cannot recite them for you right now. I'd have to get back to you.

Mr. KUCINICH. Could you give us a list of—provide this committee with a list of all the U.S. contractors who were paid in cash?

Mr. BOWEN. I will research the issue for you and get back with you on that.

Mr. KUCINICH. Mr. Chairman, I did not take that to be a positive response.

Mr. SHAYS. I think the gentleman said he would research and get back to us with that information.

Mr. BOWEN. Yes. I will try and get back with you—get that information for you.

Mr. KUCINICH. Thank you. I appreciate that.

Now let me switch to Colonel DuBose.

Colonel, this whole subcommittee meeting is about what happened to unaccounted-for funds relating to Iraqi reconstruction. Can you tell this subcommittee, out of the approximately—you get different figures, perhaps as much as $23 billion that went through the Coalition Provisional Authority's hands, and the at least $12 billion in cash that was withdrawn, according to Mr. Waxman's testimony, from the DFI account at the Federal Reserve, how much money has actually gotten down to rebuilding water systems, electricity systems, which is the whole purpose of this whole program?

Could you let the committee know what we have bought so far with all of these billions of dollars?

Colonel DUBOSE. Sir, I was only involved in the Restore Iraqi Oil program. I would have to get back with the Corps of Engineers folks. We only have visibility on our portion of that.

Mr. KUCINICH. Now, since this hearing, Mr. Chairman, is about the Development Fund for Iraq and about the reconstruction of the infrastructure of Iraq, do any of the witnesses have any information about any infrastructure improvements that have been made in Iraq with respect to water and sewer, for example, which would in any way correspond to the amount of money which is the subject of this hearing? Does anyone have a number? Mr. Bowen, can you tell?

Mr. BOWEN. I can. We are working on exactly that issue. When I went on my sixth trip to Baghdad back at the turn of the year I asked exactly this question. I said I'd like to see what it is that we built. When did these projects begin? When were they completed? And how much was the original contract and how much was the final cost? And I asked that of PTO and AID and NISTICKI, the primary entities that are spending there. And the answer I got was, that is going to shut us down, to answer your question, which raised concerns.

Mr. KUCINICH. Wait, wait, wait. What was the answer you received?

Mr. BOWEN. The answer was that we are going to have to shut down our operation in operation for 2 weeks to give you that answer. So with that, you know, we pursued the why and we found out that there are issues with respect to the information systems management of the projects, and we announced an audit. As soon as I delved into that a little bit, I announced the audit, the first stage is going to address cost to complete. If we do not know what the cost to complete is for the projects that we are building, we may be in a difficult situation with respect to what we are going to hand over. We need to be sure we have the funds available to finish what we started.

Second, we began our own initiative to try to accumulate this data, the SIGIR Iraq reconstruction information system, where we have gotten data from AID, the Corps, NISTICKI, and PCO, and accumulated into one data base. It is a work in progress, but we are trying to answer the exact question you are asking. What have we bought? How much did we pay for it? Did we get value for our dollar? Ultimately, my mission there to answer that question. And we are also trying to answer it with respect to the projects that are ongoing, and then to ultimately say, what about a project in particular? Tell me about a project.

Two days ago my auditors were out visiting El Wathba water treatment facility in Baghdad and they have come back with a report and I have a team of auditors, technical engineers, and investigators working together to answer the question you are asking, and that is: what's the quality of particular projects?

In the July 30th report you will see that. You will see pictures. You will see results. In the October report you will see a lot of that.

Mr. SHAYS. I thank the gentleman.

Mr. KUCINICH. I just want to ask the Chair that, you know, in the next round of questions I want to continue to pursue this line. Thank you.

Mr. SHAYS. Sure. Thank you.

I understand—yes, Mr. Waxman?

Mr. WAXMAN. I just want to ask Mr. Reed, on the LOGCAP contract I would like to know if you have a summary sheet for the task order values in any questioned or unsupported costs? I am not asking you to answer any questions about it, but if you have that summary I'd like you to provide that for us. Do you have it?

Mr. REED. Yes. I would be happy to provide that to you.

Mr. WAXMAN. Thank you.

Mr. SHAYS. If you provide it to the counsel, we will make sure that the same day we get it the minority gets it.

[The information referred to follows:]

DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

OFFICE OF THE DIRECTOR

Mr. Robert Briggs
Press Secretary, Government Reform Committee, Subcommittee on National Security
B-372 Rayburn House Office Building
Washington D.C. 20515

Dear Mr. Briggs,

In response to Mr. Waxman's question for the record, please find attached a summary sheet of task order values and any questioned and unsupported costs for the LOGCAP program.

Any questions on this subject should be directed to Mr. Earl Newman, Assistant Director, Operations, or Mr. Joe Garcia, Deputy Assistant Director, Operations, at (703) 767-2238.

Sincerely,

William H. Reed
Director

Enclosures:
1. Summary of Completed LOGCAP Proposal Audits

Completed Proposal Audits
on LOGCAP III Contracts

Task Order No.	LOGCAP III - Contract No. DAAA09-02-D-0007	Audit Report No.	Report Issued Date	Proposed Value	Questioned Cost	Unsupported Cost	Unresolved Cost (see Note 1)
06	Army Central (ARCENT) Force Provider Support	03521-2003D17900009	14-Aug-03	$17,754,833	$0	$0	$0
07	Labor cost, other labor related cost, equipment cost, subcontract cost and other direct cost	03521-2004D17900004	10-Nov-03	$1,811,000	$0	$0	$0
13	Services necessary to support base camp operations at Site 2 in Afghanistan.	03311-2004K21000018-S1	26-Jul-04	$154,419,109	$3,001,760	$1,326,470	$0
14	Base Operations at Site 3 for Kandahar, Afghanistan, Arcent Force Provider, Water packing system – Consolidate Ice Plant	03311-2004K21000019	23-May-04	$124,727,145	$1,260,857	$0	$0
15	Operation and Maintenance Support in Djibouti	03311-2004K21000033-S1	22-Nov-04	$114,662,970	$13,528,280	$596,785	$0
27	Base camp services, accommodations, life support services, and selected Combat Support/Combat Service Support (CS/CSS) Functions to the Arifjan AOR base camps to include the Field Repair Activity (FRA) and the Theater Aviation Maintenance Program (TAMP) R	03311-2005K21000007	21-Jan-05	$281,118,118	$18,331,441	$16,563,868	$0
28	Housing and sustaining U.S. Forces as well as upgrading of Host Nation equipment and facilities	03311-2004K21000013	6-May-04	$11,893,474	$52,119	$302,227	$0
31	Unspecified site	03311-2004K17900048	11-May-04	$2,016,452	$29,176	$0	$0
33	All services necessary to complete Site 6 tasks in support of Operation Iraqi Freedom under the Logistics Civil Augmentation Program	03311-2004K17900045	27-Apr-04	$38,541,930	$1,056,583	$0	$0
34	Base operations at site 5A for Sea Port of Debarkation (SPOD)	03311-2005K21000023	3-Mar-05	$67,209,399	$5,749,667	$223,345	$0
35	Base Operations at Site 5B - I for Operation Iraqi Freedom	03311-2004K21000010	22-May-04	$49,364,798	$736,266	$0	$34,527,986
36	Base Operations at Site 5A	03311-2004K21000022	17-Sep-04	$278,428,603	$2,033,979	$30,367,964	$179,923,880
37	KBR mission support requirements	03311-2004K21000014	10-May-04	$1,651,043	$52,256	$0	$0
38	KBR mission support requirements; Base Operations at Site 5J-O – airfield operations, firefighting services and basic services to the CSH.	03311-2005K21000012-S1	14-Feb-05	$62,294,601	$4,182,196	$9,823,489	$0
40	Construction costs and services	03311-2004K17900010	25-Mar-04	$49,913,272	$7,039,216		
41	Base operations	03311-2004K17900051	20-May-04	$3,448,850	$75,837	$584,820	$0
43	Base Operations at sites 5AX, 5NX, 7AX, 7BX, 7CX, 7SX, and ASX for the Theater Transportation Mission, Task	03311-2005K21000001-S1	14-Jan-05	$834,566,932	$21,037,028	$11,741,585	$0
44	Services to support the Coalition Provisional Authority	03311-2005K21000003	23-Dec-04	$581,468,752	$34,294,911	$52,586,818	$0
45	HQ-CFJCC-C8 Site 5a -LSE SWA Support	03311-2004K21000025	25-Jun-04	$2,962,573	$344,075	$711,283	$0
46	Base operations at Sites 7A-F for Enemy Prisoner of War (EPW) Camps in Iraq	03311-2005K21000008	12-Feb-05	$72,214,257	$5,055,080	$363,324	$0
47	Mission support for Site 1, Uzbekistan	03311-2005K21000010	25-Jan-05	$82,946,339	$1,348,234	$6,772,128	$1,452,948
48	Construction costs and services	03311-2004K17900049	2-May-04	$585,090	$2,563	$0	$0
50	Providing all services necessary to augment and support the site 5R Theatre Bulk Fuel Mission tasks in support of Operation Iraqi Freedom	03311-2004K21000035	8-Sep-04	$45,943,543	$13,924,245	$1,255,641	$558,700

Completed Proposal Audits on LOGCAP III Contracts

Task Order No.	LOGCAP III Contract No. DAAA09-02-D-0007	Audit Report No.	Report Issued Date	Proposed Value	Questioned Cost	Unsupported Cost	Unresolved Cost (see Note 1)
53	Base operations at Site 2B for Afghani Waterworks	03311-2004K17900050-S1	28-May-04	$33,729,032	$644,794	$5,790,677	$0
54	Services to support the US/Coalition Forces at the Kabul, Afghanistan Military Training Center, Site 2AX	03311-2005K21000009	10-Jan-05	$6,629,132	$94,049	$64,477	$0
56	Providing the services, resources, and management necessary to provide logistics and life support for the Defense Intelligence Agency's (DIA) Iraq Survey Group (ISG) in Iraq	03311-2004K21000034-S1	9-Sep-04	$190,636,416	$27,373,012	$6,340,647	$22,819,665
57	Provides the mission support requirements for Base Operations at Site 7NX for LSA Adder	03311-2005R21000001	8-Mar-05	$266,095,669	$33,861,183	$2,488,669	$0
58	Base camp operations, planning, and execution, Logistics Services, and other designated support services for Site 5T and life support for coalition forces	03311-2005R21000002	11-Mar-05	$242,536,746	$31,688,074	$12,200,070	$0
59	Support services to U.S. and coalition forces in Iraq (see Note 2)	03311-2005K22000002	24-Mar-05	$5,876,000,000	$432,051,032	$189,996,034	$0
60	Mission support requirements for Base Operations at Site 2C – Kabul Compound	03311-2004K21000023	1-Aug-04	$10,025,684	$825,840	$2,368,424	$0
61	Base Operations at Site G1-7	03311-2004K21000043	29-Oct-04	$350,138,664	$59,197,137	$6,978,516	$164,015,241
62	Operation and maintenance of a US/Coalition Forces base camp at the Site 2D - Trainer Compound	03311-2005K21000006	7-Dec-04	$12,387,685	$236,792	$35,724	$0
63	Services at Site 5 for Federal Deployment Centers (FDC) being conducted at two sites: FDC Fort Belvoir, VA (FDCS) and FDC Kuwait – Hilton (FDCK) in support of Operation Iraqi Freedom	03311-2004K21000036	9-Sep-04	$6,649,590	$131,872	$65,152	$0
64	New Iraqi Army Trainer and Coalition Support	03311-2004K21000039	10-Sep-04	$33,535,696	$592,160	$740,876	$13,857,500
66	Provides logistics support for the Kuwait Naval Base	03311-2004K21000009	6-May-04	$7,261,097	$383,356	$0	$2,630,084
72	Army Oil Analysis Program (AOAP)	03311-2004K21000038	7-Sep-04	$2,355,442	$0	$0	$0
75	Provide the services, resources, and management necessary for calibration and repair services for the Army's test, measurement, and diagnostic equipment division (TMDE) inventory utilizing government and contractor furnished calibration equipment	03311-2004K21000006	18-Mar-04	$3,462,483	$61,575	$0	$0
81	Provides for mission support requirements for Navistar – Camp Big Sky Oasis	03311-2004K21000041	7-Sep-04	$8,990,709	$734,833	$523,765	$158,360
84	Mission support requirements for Site 3A, Fire Base Salerno, Iraq	03311-2005K21000013	14-Jan-05	$45,012,080	$529,762	$8,651,532	$0
85	Provides all services necessary to augment and support the Sustainment and Stability Operations Program (SSOP) tasks in support of Operation Iraqi Freedom	03311-2005K21000028	26-Mar-05	$22,332,131	$299,375	$51,181	$0

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Completed Proposal Audits
on LOGCAP III Contracts

Task Order No.	LOGCAP III Contract No. DAAA09-02-D-0007	Audit Report No.	Report Issued Date	Proposed Value	Questioned Cost	Unsupported Cost	Unresolved Cost (see Note 1)
86	Provide services, resources, and management necessary to perform base camp operations, planning and execution, logistic services, as required services and other designated support services for the SPOD Facilities and Life Support for Coalition Forces at S	03311-2005K21000029	31-Mar-05	$17,815,346	$3,230,389	$602,699	$0
90	Provides for services to support Site 5A – Camp Arifjan	03311-2005K21000030	7-Apr-05	$78,987,843	$5,613,410	$1,794,948	$0
92	Provides selected logistical support operations at designated locations throughout the Combined Joint Operations Area (CJOA) in Afghanistan and Uzbekistan	03311-2005K21000031	19-Apr-05	$25,182,954	$1,307,987	$96,089	$0
93	Services for the Udairi Facilities and Life Support for Coalition Forces at Site 5	03311-2005K21000011	12-Jan-05	$14,750,561	$541,543	$136,007	$0
94	All services necessary to augment and support the Site 4 - Djibouti Year 3 Mission Tasks	03311-2005K21000004	23-Dec-04	$55,740,675	$372,418	$3,349,246	$0
95	Provides for support services to U.S. and Coalition Forces at Kabul Compound, Afghanistan, (currently CJCMOTF)	03311-2005K21000027	18-Feb-05	$16,332,830	$578,198	$65,125	$0
97	Augment and support Site 2, Bagram Air Force Base, Afghanistan	03311– 2005K21000014-S1	3-Mar-05	$210,057,257	$4,303,981	$5,007,158	$3,049,500
98	Provides for services to support SITE 3 – Kandahar Air Field Mission	03311-2005K21000021	3-Mar-05	$149,011,424	$38,238,819	$702,542	$0
100	Life support to all persons and organizations that support the Chief of Mission (COM)	03311-2005K21000015	8-Mar-05	$305,530,836	$58,059,455	$7,718,681	$0
49	**TOTAL**			**$10,871,131,065**	**$834,086,815**	**$388,987,986**	**$422,993,864**

Note 1. Unresolved costs arise when requested assist audit reports are not available for incorporation into the final audit report. In the case of the above LOGCAP task orders, the two reasons for the unresolved costs in the Arlington Branch Office reports were Iraq Branch Office assist audit reports not yet received and in-process audits of dining facilities (DFAC) costs (see note 3 below for details on dining facility reviews).

Note 2. DCAA was requested to review only certain parts of the proposal for Task Order 59. The subject report reflects the proposed amounts for the cost elements we reviewed and not the entire proposed value. The amount reflected here is the total proposal value.

Note 3. Subsequent to the issuance of the above audit reports, DCAA issued 4 additional audit reports addressing dining facility costs across multiple task orders. These audits superseded cost questioned or unresolved in a number of the above task orders. These four audits are detailed below:

Description	Audit Report No.	Report Issued Date	Questioned Cost
Dining Facility Sites 5-A, 5-B, 5-C	03311-2004K179000091	19-Aug-04	$25,983,039
Dining Facility Site D-7	03311-2004K179000083	10-Sep-04	$13,293,961
Dining Facility Sites D-5.1, H-1, H-2, I-3, H-4, H-5	03311-2004K179000075	14-Sep-04	$54,814,758
Dining Facility Sites C-2, C-3, C-4, D-6	03311-2004K179000077	29-Sep-04	$40,240,236

Mr. SHAYS. Let me just say for the benefit of the Members, we have an issue of cash, we have an issue of redaction. Gentlemen on our panel, if I am incorrect about how I described it, I want you to tell me where I am incorrect just so we know who has the answers to this issue. On the issue of cash, it is my understanding that you, Mr. Bowen, can speak to this, and you, Mr. Benkert, can speak to this. On the issue of redactions, it is my understanding Mr. Reed, Colonel DuBose, and Mr. Norquist, you can speak to that.

Mr. Reed as the DCAA, you do the audits and you recommend what is fair and reasonable? That is my understanding.

Let me just go forward. You, Colonel, your responsibility is you hire and pay the contracts and sometimes you chase overpayments, if there is, and you ultimately decide what is fair and reasonable based on the recommendations of Mr. Reed.

Let me just go forward here one more, and then correct me where I am wrong. It is my understanding that, Mr. Norquist, you worked out of the comptroller's office, was DOD's contact with the IAMB, correct, with U.N.?

Mr. NORQUIST. I was the observer to the IAMB, yes, sir.

Mr. SHAYS. Right. And the liaison, in a sense?

Mr. NORQUIST. In effect that is what happened.

Mr. SHAYS. OK. So with what I have described, is there any qualification or additions that you need to make so we make sure we are not ignoring your contribution? Is there anything that I have described that needs to be amended by any of you?

Mr. NORQUIST. No.

Mr. SHAYS. Any additions to?

[No response.]

Mr. SHAYS. At this time let me tell you the order to which I have Members. I have Mr. Higgins, who is not here, so I would go to Mr. Ruppersberger. Then I would go to Mr. Maloney, then I would go to Mr. Sanders, and then I would go to Mr. Lynch. Is that the order in which you arrived? I believe that is correct. OK. So at this time, Mr. Ruppersberger, you have the floor.

Mr. RUPPERSBERGER. Sure. Mr. Chairman, first I want to thank you and Ranking Member Waxman for having this hearing. It seems to me that we have a lot of work to do based on what our job is in Congress from an oversight capacity. It concerns me greatly that we from the very beginning did not set up the proper system that we need to set up to really monitor cash, where cash is going, and to prevent fraud.

Unfortunately, because of this fact that we have not set up the proper system, we have not been able to put the money back into the Iraqi economy to win the hearts and minds of the people, which hopefully will eventually bring our troops home. And I think it is important that we become a lot more aggressive in this oversight ability to really find out where the cash is.

Just right now, moneys have not been held accountable, what I have heard from the testimony. We have $8 billion that have come from oil for food. We have $12 billion that have come from oil proceeds. That is $20 billion right there; $20 billion is a lot of money.

Now, let's get the specifics. If we are going to fix the problem, we have to learn what we did in the past, what we have not done, and what we are going to do now.

Mr. Bowen, first thing I want to point out, when the CPA started with Bremer he promulgated regulations, and one of the regulations is the CPA shall obtain the services of an independent certified public accounting firm to ensure transparency and compliance with Resolution 1483.

Now let me ask you this question. Did the CPA ever hire a certified public accounting firm?

Mr. BOWEN. They hired the Northstar Co. which had CPAs on it, and the purpose of that employment was to meet that standard. As I mentioned earlier, the mission of that entity changed pursuant to the comptroller's verbal direction, converting them more to an assist organization in managing the accounting records of the DFI.

Mr. RUPPERSBERGER. Were they a certified public accounting firm?

Mr. BOWEN. No, sir.

Mr. RUPPERSBERGER. OK. So the fact that they were not a certified public accounting firm, that is step one. Do you think they should have hired a certified public accounting firm based upon the rules that were promulgated and also based on the standard in the industry of accounting? Should we have at that point hired a certified public accounting firm, in your opinion?

Mr. BOWEN. I think that would have been a better choice.

Mr. RUPPERSBERGER. And I understand that Northstar was working out of a private home in San Diego and they received a $1.4 million contract to audit this situation; is that correct, based on your knowledge?

Mr. BOWEN. I do not know the details of their corporate headquarters in California. I did interact with the Northstar personnel in the comptroller's office and they were professional.

Mr. RUPPERSBERGER. Had you ever heard of them before they were hired?

Mr. BOWEN. No.

Mr. RUPPERSBERGER. Do you know who hired them?

Mr. BOWEN. No, I do not specifically.

Mr. RUPPERSBERGER. Do you know what department hired them?

Mr. BOWEN. They were retained by CPA through DOD.

Mr. RUPPERSBERGER. And do you know why they were hired? Did they have any certain expertise or anything?

Mr. BOWEN. That occurred long before I arrived in Baghdad.

Mr. RUPPERSBERGER. And, by the way, these questions—we need to be specific and strong. It has nothing personally about you all. We want you all to fix the problem, but we have to raise these issues.

Now, you examined the Northstar contract in one of your reports. According to the CPA, Northstar was hired not to audit but to consult with the CPA on transparency. What do you know about that part of the contract?

Mr. BOWEN. I have not reviewed that part of the contract. I know we looked at what Northstar generally did in connection with the DFI audit, and we concluded that they did not carry out the mission that the CPA order required.

Mr. RUPPERSBERGER. So basically they really did not work as a certified public accounting firm. Do you know what they were there for? What was the purpose?

Mr. BOWEN. Well, as I said they were ostensibly hired to provide internal audit expertise. They functionally were converted into an assist organization with respect to maintaining accounting records on DFI disbursements.

Mr. RUPPERSBERGER. You know, we have done a lot in Iraq. Whether for or against the war, it is about the troops and supporting the troops and doing the things that we need to do right now. It just seems to me that billions of dollars that are held unaccountable, it is just unacceptable, and that we have to do better.

Now, one of the things an investigation—when you conduct investigations, you follow the money.

Mr. BOWEN. Yes, that is right.

Mr. RUPPERSBERGER. From your perspective, let's talk about following the money. We have what my numbers—what I have heard in testimony, about $20 billion. Do you feel there is more that is unaccountable, or do you feel that is the number that we have out there now, between the oil for food, the money that was given to the ministers? What amount do we have, or cannot you answer that question? Do we really have a handle on how much is really missing or held unaccountable that we are responsible, the CPA is responsible for managing?

Mr. BOWEN. There were two types of money in Iraq. There was the DFI essentially, speaking generally, the DFI $19-plus billion and then the IRF, which is taxpayer money, the appropriated dollars, amounting to roughly $21 billion. The former, the $19 billion, was used to fund the stand-up of the Iraqi government and to initiate a wide variety of reconstruction activities. The IRF—IRF I and IRF II, if you will—IRF I was roughly $3 billion in April 2003 and $18.4 billion in November 2003, was used for the reconstruction program that we are currently executing.

Mr. RUPPERSBERGER. You know, the fact that we have all this unaccounted money is just very serious. The fact that we from the very beginning did not set up the right system or hire the certified public accounting firm whose job it would be independently to determine and follow where the money is is serious.

What I would like to hear from you is what do you feel we need to do now. What systems do we need to set up to find this cash and follow this cash. But before you answer that—because I see my yellow light—that money that went to the ministers, did some of that go to Chalabi?

Mr. BOWEN. I do not know the answer to that question.

Mr. RUPPERSBERGER. Well, I think we need to look into that also, because of past record. But could you ask what do we need to do now? We have talked about where we were. What systems do we need to set up, in your opinion, do you think we will be able to find and hold those people accountable, whether it is within our government or the Iraqi government on this amount of money? We have Oil-for-Food scandals. We have this situation now. It is getting out of control and it is hurting our situation in Iraq.

Mr. BOWEN. That is a good question. The DFI money is within the sovereignty of the Iraqi government. Just so you know, I have

met several times with the Commissioner on Public Integrity, Judge Roddy, and he and I have a good working relationship. He and the Iraqi anti-corruption system, which we have helped stand up—there are 29 IGs that we helped train that are working within Iraqi ministries now tracking exactly what you are talking about. Third, the border supreme audit—we have helped guide them to—there are three incipient but sound pillars of anti-corruption within the Iraqi government. They have taken on this mission. There is a fiscal anti—it is called the Fiscal Integrity Commission within the interim Iraqi government, the current Iraqi government, that is examining every contract over $3 million.

So yes, they are tracking what happened to this money. They are pursuing accountability, and partly because of the audit work we have done to draw attention to this issue, to the lack of controls. But it is on that side of the fence, so to speak, and they are pursuing it.

On our side we are focused on appropriated dollars. We are looking at how the IRP is being used, has been used, and will be used.

Mr. RUPPERSBERGER. My time is up, but I would like you to get back to me on what person or individual or department determined that we should hire Northstar to monitor, because I think that is the beginning of where this has started. The problem started with that and it has continued on.

Mr. BOWEN. Yes, sir.

[The prepared statement of Hon. C.A. Dutch Ruppersberger follows:]

Congressman C. A. Dutch Ruppersberger
June 21, 2005
Development Fund for Iraq Hearing
Subcommittee on National Security, Emerging Threats & IR
2154 Rayburn HOB – 10:00 A.M.

Mr. Chairman, I want to thank you for calling this hearing on the management of Iraq Oil proceeds and compliance with U.N. Resolutions. I hope we can learn more about what is going on, but more importantly we need to fix the situation so that Iraqi's can use the sale of oil to rebuild their country. The rebuilding of Iraq is a national security priority.

We moved funds from the mismanaged Oil-For-Food program to the Development Fund for Iraq. The Development Fund for Iraq is to be used for a good cause for the humanitarian and reconstruction needs of the Iraqi people. It is supposed to go to the needs of the people. This idea is something that I think a lot of Members support, the use of Iraqi oil to help rebuild their own country.

We need strong reconstruction in Iraq. We need to give the Iraqi people jobs so that they are part of the solution and more importantly that they are no longer a target for recruitment to attack U.S. and Iraqi Security forces trying to establish peace. We need those funds to rebuild the country so that we can show the world some progress in the country.

However mismanagement and a draw down of funds that have gone missing raises serious concerns about what is going on?

For example the interim government bartered petroleum products for electricity and other oil products from Syria in transactions worth $461 million dollars. It later deposited $97.7 million dollars from oil sales into its own bank accounts, a direct violation of the UN Resolution. KPMG in an audit of the development fund says the Coalition's poor management has left the Fund "open to fraudulent acts."

We turned money over to this new fund with the request that any transaction be transparent and in the open. We need an honest accounting and inventory of spending. The use and sale of oil in Iraq for their reconstruction and security is an important solution, but if the sale of oil is being mismanaged then we need to look into the problem and fix it. How can we win in Iraq if their greatest resource is mismanaged? How can we expect to bring our soldiers home when the only income the country has is wasted? We need these funds to go to reconstruction. We need to allow the Iraqis to use their best asset, oil, to defeat the insurgents and to establish their own stability.

Mr. RUPPERSBERGER. I think it is important that we get that information so we can analyze why that decision was made. Thank you.

Mr. BOWEN. I will get that for you.

Mr. SHAYS. I thank the gentleman.

Before recognizing Mrs. Maloney I'd ask unanimous consent to include in the record the CSR memorandum on applicable laws on the disclosure of proprietary information dated June 20, 2005.

Does the minority have a copy of that?

VOICE. Yes.

Mr. SHAYS. OK. And without objection, so ordered.

[The information referred to follows:]

Memorandum June 20, 2005

TO: House Subcommittee on National Security, Emerging Threats, and International Relations
Attention: Chairman Christopher Shays

FROM: Morton Rosenberg
Specialist in American Public Law

Gina Marie Stevens
Todd B. Tatelman
Legislative Attorneys
American Law Division

SUBJECT: Permissibility of Disclosure by the Department of Defense of Proprietary Data Asserted to be Proprietary under the Trade Secrets Act and the Freedom of Information Act to the Congress and to the Public

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This memorandum has been prepared in response to your letter of June 17, 2005, requesting our testimony for the Subcommittee's June 21 hearing. You asked for CRS views on whether the Freedom of Information Act (FOIA) or the Trade Secrets Act prohibits the Department of Defense (DoD) from disclosing "questioned costs" and "unsupported costs" identified by government auditors in a government audit report. Specifically, your request concerns selected information, namely conclusions contained in the audit report relating to the Proposal for Restore Iraqi Oil (RIO) Task Order No. 5 submitted on October 8, 2004 by the Defense Contract Audit Agency (DCAA).[1]

Based on our review of publicly available information, information provided by the Subcommittee to CRS, our discussions with Committee staff, as well as the relevant statutory language, case law, and agency rules, it appears that your question is best divided into two parts. The first part concerns the DoD's legal authority to disclose unredacted questioned and unsupported cost information contained in the audit report to a requesting committee or subcommittee chairman, or ranking minority member of a jurisdictional committee. The second question concerns DoD's legal authority, pursuant to FOIA and the Trade Secrets Act,

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[1] DCAA's objective is to assist in achieving prudent contracting by providing the DoD officials responsible for procurement and contract administration with financial information and advice on contracts and contractors, where appropriate. *See* 32 C.F.R. § 290, App. A. (2004). DCAA's FOIA rules are located at 32 C.F.R. § 290 (2004).

to disclose unredacted questioned and unsupported cost information contained in the audit report to the general public pursuant to a FOIA request.

Our review of the facts and circumstances submitted and the applicable statutes, agency rules, and case law indicates that full disclosure to a requesting jurisdictional congressional committee is mandated here both by Congress's constitutionally-based oversight and investigatory powers and by the statutory prohibition against any withholding of such information from "Congress, a committee or a subcommittee of Congress."[2] Moreover, once in the possession of a congressional committee, it is within the discretion of a committee to disseminate such information through actions taken in the legislative sphere for legislative purposes. With respect to DoD's authority to withhold disclosure under the Trade Secrets Act and Exemption 4 of FOIA, a closer question is presented. Case law interpretation of Exemption 4, however, supports an argument that an audit report, such as the one prepared by DCAA, to the extent that it reflects the analysis and conclusions of the auditing agency, and is not merely a reiteration of the information supplied by the submitter, therefore, is not information "obtained by a person" as required by FOIA.

Background

As we understand the facts and circumstances, the government-generated audit report, which identified "questioned and unsupported costs,"[3] was derived from cost or pricing data and other information made available to government auditors by the contractor. The chronology of events appears to be as follows:

> In October 2004, the Subcommittee began an oversight investigation of Development Fund for Iraq (DFI) contracting and reconstruction efforts. On October 5, 2004, the Subcommittee requested DoD forward DFI audits, documents, and financial records related to Iraqi reconstruction efforts. On November 15, 2004, DoD provided a partial response and *redacted audits* of the Restore Iraqi Oil (RIO) contract task orders 5 through 10. On March 15, 2005, the Subcommittee again requested in writing that DoD provide the unredacted audits of the Restore Iraqi Oil (RIO) contract task orders 5 through 10 originally requested in October 2004. On March 24, 2005, the Department of the Army delivered to the Subcommittee updated and revised *unredacted DCAA audits* of Restore Iraqi Oil contract task orders 5 through 10.[4]

Legal Authority to Disclose Information to Congress

At its core, the first portion of our inquiry concerns Congress's ability to obtain information necessary to perform investigations and oversight regarding an executive agency's dealings with a government contractor. Generally speaking, Congress's authority

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[2] *See generally,* 5 U.S.C. § 552 (2005).

[3] The phrase "unsupported costs" refers to those costs that lack adequate support documentation to justify payment, while "questioned costs" are those costs that have support documentation, but that the auditor nevertheless concludes are not fairly or reasonably attributed to the contract.

[4] Briefing memo for the hearing entitled, The Development Fund for Iraq: U.S. Management of Iraq Oil Proceeds and Compliance with U.N. Security Council Resolution 1483, June 16, 2005 (internal citations omitted) (emphasis added).

and power to obtain information, including but not limited to proprietary information, is extremely broad.[5] While there is no express provision of the Constitution or specific statute authorizing the conduct of congressional investigations, the Supreme Court has firmly established that such power is essential to the legislative function as to be implied from the general vesting of legislative powers in Congress.[6]

The federal courts, in applying Congress's broad investigatory power to obtain access to documents containing confidential or proprietary information, have expressly held that executive agencies and private parties may not deny Congress access to such documents, even if they may contain trade secrets whose disclosure to the public is otherwise statutorily barred.[7] Specifically, courts have held that release of information to a congressional requestor is not considered to be disclosure to the general public[8] and once documents are in congressional control, the courts will presume that committees of Congress will exercise their powers responsibly and with proper regard to the rights of the parties.[9] Moreover, it would appear that courts may not prevent congressional disclosure at least when such disclosure would serve a valid legislative purpose.[10]

Executive agencies have previously attempted to argue that several statutes of general applicability prevent the disclosure of information to congressional committees. A frequently cited statute to justify non-disclosure is the Trade Secrets Act, a criminal provision that generally prohibits the disclosure of trade secrets and other confidential business information by a federal officer or employee "unless otherwise authorized by law."[11] A review of the Act's legislative history, however, provides no indication that it was ever intended to apply to Congress, its employees, or any legislative branch agency or its employees.[12] Moreover, as a matter of statutory construction it would appear to be unusual for Congress to subject, *sub silento*, its staff to criminal sanctions for such disclosures, especially given its well-established oversight and investigative prerogatives, and its

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[5] Proprietary information is commonly understood to encompass both trade secrets and confidential business information.

[6] *See e.g., Nixon v. Administrator of General Services*, 433 U.S. 435 (1977); *Eastland v. United States Servicemen's Fund*, 421 U.S. 491 (1975); *Barnblatt v. United States*, 360 U.S. 109 (1959); *Watkins v. United States*, 354 U.S. 178 (1957); *McGrain v. Daugherty*, 273 U.S. 135 (1927).

[7] *See e.g., F.T.C. v. Owens-Corning Fiberglass Corp.*, 626 F.2d 966, 970 (D.C. Cir. 1980); *Exxon Corp. v. F.T.C.*, 589 F.2d 582, 585-86 (D.C. Cir. 1978), *cert denied* 441 U.S. 943 (1979); *Ashland Oil Co., Inc. v. F.T.C.*, 548 F.2d 977, 979 (D.C. Cir. 1976).

[8] *See Owens-Corning Fiberglass Corp.*, 626 F.2d at 970; *see also Exxon Corp.* 589 F.2d at 589; *Ashland Oil*, 548 F.2d at 979; *Moon v. CIA*, 514 F.Supp 836, 840-41 (S.D.N.Y. 1981).

[9] *See Owens-Corning Fiberglass Corp.* 626 F.2d at 974; *see also Exxon Corp.* 589 F.2d at 589; *Ashland Oil*, 548 F.2d at 979; *Moon v. CIA*, 514 F.Supp at 849-51.

[10] *See Doe v. McMillan*, 412 U.S. 306 (1973); *see also Owens-Corning Fiberglass Corp.* 626 F.2d at 970.

[11] 18 U.S.C. § 1905 (2005).

[12] *See CNA Financial Corp. v. Donovan*, 830 F.2d 1132, 1144-52 (D.C. Cir. 1987) (discussing in depth the legislative history of the Trade Secrets Act).

Constitutional privilege with respect to Speech or Debate.[13] As such, there appears to be little doubt that disclosure to Congress of proprietary information covered by the Trade Secrets Act would be deemed to be "authorized by law."

The Supreme Court held in *Chrysler v. Brown*[14] that disclosure authorization can stem from not only congressional enactments, but also agency regulations. There appears to be at least two potential sources of general disclosure authorization. The first is 2 U.S.C. § 190d, which directs all standing committees of Congress to engage in continuous legislative oversight of the administration and application of laws within their respective jurisdictions, and such committees "may require a Government agency" to assist in doing so.[15] In 1955, the Attorney General of the United States opined that the authorization required by the Trade Secrets Act was "reasonably implied" under section 190d.[16] A second source of authorization is the rules of each House authorizing committee oversight. In sum, it appears likely that not only would a reviewing court hold the Trade Secrets Act inapplicable to any release of proprietary information to Congress, but also that it was never intended to apply to public releases by Members or staff in the course of the performance of their legitimate legislative functions.

As mentioned above, it is worth noting that the public release of such proprietary information, either through inclusion in a hearing record or via the Congressional Record, appears to be protected by the Speech or Debate Clause. Moreover, because this information does not appear to include classified material, it is unlikely that release or publication would be deemed to violate the ethics rules of the House.

The purpose of the Speech or Debate Clause[17] is to assure the independence of Congress in the exercise of its legislative functions and to reinforce the separation of powers established in the Constitution.[18] Courts, including the Supreme Court, have read the clause broadly, holding that it protects "purely legislative activities," including those considered inherent in the legislative process.[19] In addition, courts have held that the protection afforded by the clause is not limited to words spoken during debate, but extends to "committee reports, resolutions, and the act of voting ..., as are things generally done in a session of the House by one of its members in relation to the business before it."[20] Finally, the clause has been held to encompass such activities integral to the lawmaking process as the circulation

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[13] *See* U.S. CONST. Art. 1, § 6, cl. 1.

[14] *Chrysler v. Brown*, 441 U.S. 281, 301-16 (1979).

[15] 2 U.S.C. § 190d (2005).

[16] *See* 41 Op. Atty. Gen. 221 (1955).

[17] U.S. CONST. Art. 1, § 6, cl. 1 (providing that "for any Speech or Debate in either House, [Members] shall not be questioned in any other place").

[18] *See Eastland*, 421 U.S. at 502-03.

[19] *See id.*; *see also United States v. Swindall*, 971 F.2d 1531, 1534 (11th Cir. 1992); *Chastain v. Sundquist*, 833 F.2d 311, 314 (D.C. Cir. 1987), *cert denied* 487 U.S. 1240 (1988) (*quoting United States v. Brewster*, 408 U.S. 501, 512 (1972).

[20] *Powell v. McCormack*, 395 U.S. 486, 502 (1969).

of information to other Members, as well as participation in committee investigative proceeding and reports.[21]

As broad as the Speech or Debate Clause's protection is, however, it does not appear to extend to activities only casually or incidentally related to legislative affairs.[22] For example, newsletters, press releases, or the direct dissemination of documents or reports containing information or quotes from documents circulated by a Member to the general public will likely not be shielded, because they are considered "primarily means of informing those outside the legislative forum."[23] On the other hand, the dissemination of such documents or reports to Members of a Committee and/or their staff, or the inclusion of such information or reports in the public record of hearings or the Congressional Record are likely to be considered "integral" and, therefore, protected by the Clause. The key consideration is such cases appears to be the act presented for examination, not the actor.

In this case, it would not appear that the DoD has any legal authority to withhold the information, proprietary or not, from the Congress. In addition, it would appear that once the information from the DoD is received and included as part of an activity considered "integral" to the legislative process, such as a oversight hearing transcript or the Congressional Record, it can be released to the general public without penalty as it would be protected by the Speech or Debate Clause.[24]

Legal Authority to Disclose Information to the Public

In contrast to the first question relating to the disclosure of proprietary information to Congress, and the release by Congress in the course of legislative proceedings, the legal authority with respect to DoD's disclosure of unredacted questioned and unsupported costs information in the audit report to the public pursuant to an FOIA request is much less clear. As previously mentioned, the disclosure of proprietary or confidential business information by government officials is potentially governed by both the Trade Secrets Act and the Freedom of Information Act (FOIA). We will address both statutes in turn.

Trade Secrets Act. A federal criminal law, the Trade Secrets Act, prohibits federal employees from divulging, in any manner or to any extent not authorized by law, any trade secrets they obtain in the course of employment. The Trade Secrets Act states, in relevant part, that

> [w]homever, being an officer or employee of the United States or of any department or agency thereof ... publishes, divulges, discloses, or makes known in any manner or to any extent not authorized by law any information ... which concerns or relates to the *trade*

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[21] *See e.g., Doe v. McMillan*, 412 U.S. 306, 311-12 (1973); *Gravel v. United States*, 408 U.S. 606, 625 (1972); *Dombrowski v. Eastland*, 387 U.S. 82 (1967); *Tenney v. Brandhove*, 341 U.S. 367, 376-77 (1951).

[22] *See Walker v. Jones*, 733 F.2d 927, 929 (holding that activities integral to the legislative process may not be examined, but peripheral activities not closely connected to the business of legislating do not get protection under the clause).

[23] *Hutchinson v. Proxmire*, 443 U.S. 111 (1979).

[24] It should be noted that while there are no legal penalties for disclosure by Congress, there may be practical considerations that may be seen as a deterrent to voluntary submission.

> *secrets*, processes, operations, style of work, or apparatus, or to the identity, confidential statistical data, amount or source of any income, profits, losses, or expenditures of any person, firm, partnership, corporation, or association; ... shall be fined under this title, or imprisoned not more than one year, or both; and shall be removed from office or employment.[25]

Neither the statute itself, nor its legislative history provides a definition of the term "trade secret." In other words, there appears to be no federal law relating to trade secrets or to the tort of trade secret misappropriation. In the absence of directly applicable federal law, courts will generally look to the applicable state law in deciding cases regarding trade secrets.

Even at the state level there appears to be no uniformly accepted definition of what constitutes a trade secret. In fact, according to one treatise, trade secrets are almost impossible to define objectively.[26] That being said, the most widely quoted definition of a trade secret is reflected in Comment (b) of § 757 to the Restatement of Torts.[27] The Restatement's definition of a trade secret includes:

> any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it.[28]

In addition to the Restatement's definition, alternative definitions are contained in the Uniform Trade Secrets Protection Act[29] as well as in many state specific statutes.[30] In 1979, the National Conference of Commissioners on Uniform State Laws approved a Uniform Trade Secrets Act, which includes the following definition (in § 1(4)):

> "Trade secret" means information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

The Uniform Trade Secrets Act is the law in most states, although with modifications in some.[31]

It has been noted that:

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[25] 18 U.S.C. § 1905 (2005) (emphasis added).

[26] James T. O'Reilly, FEDERAL INFORMATION DISCLOSURE § 14.5 (3d. Ed. 2000) [hereinafter O'Reilly].

[27] Annotation, *Disclosure of Trade Secret as Abandonment of Secrecy*, 92 ALR3d 138, 145 n.7.

[28] Restatement of Torts § 757, Comment b (1938).

[29] *See* Uniform Trade Secrets Protection Act, § 1(4) (1971).

[30] *See e.g.*, IDAHO CODE § 48-801; ILL REV. STAT. ch. 765 § 1065/2(d) (1993); NEB. REV. STAT. § 87-502; CONN. GEN. STAT. ANN. § 35-51 (1987); OR. REV. STAT. 646.461 (1989); ALASKA STAT. 45.50.940(3) (1989).

[31] 14 UNIFORM LAWS ANNOTATED 433 (1990) and 2004 Cumulative Annual Pocket Part at 236. 44 states plus the District of Columbia have adopted it.

> The concept of a trade secret is at best a nebulous one which has been variously described by courts and text writers. The nature of a trade secret is such that so long as it remains a secret it is valuable property to its possessor, who can exploit it commercially to his own advantage. Although it may be so obvious as to be redundant, the subject matter of a trade secret must be secret. Thus, a trade secret is something known only to one or a few, kept from the general public, and not susceptible of general knowledge, so that matters of public knowledge or of general knowledge in a particular industry cannot be appropriated by one as a trade secret.[32]

A leading commentator on information disclosure law has observed that "... like beauty, trade secrecy is sometimes in the eye of the beholder, and always difficult to define objectively."[33]

The case law annotations discuss the impact of disclosure on trade secret status.

> It is frequently necessary in the commercial milieu for the possessor of a trade secret to disclose it to another person or persons, such as business associates, employees, licensees, etc.... Because a trade secret must be secret, disclosure may mean that knowledge of it becomes so widely known as to result in an abandonment of the essential element of secrecy and in a destruction of trade secret status.... The circumstances under which disclosure of a trade secret is made are often noted by the courts as bearing upon the question whether disclosure was so public as to have resulted in abandonment. The existence of confidential circumstances surrounding the disclosure of a trade secret is frequently cited by the courts as tending to negate abandonment, because such circumstances require the person to whom the trade secret is divulged to respect and maintain the secrecy of the trade secret.[34]

To summarize, then

> The crucial issue to be determined in cases involving alleged trade secrets is whether information sought to be protected is, in fact and in law, confidential or secret; and the result in each case depends on the conduct of the parties and the nature of the information.[35]

In *Wilkes v. Pioneer American Insurance Co.*,[36] the plaintiffs claimed to have developed a trade secret (a method of marketing), which they disclosed to the defendant (an insurance company) pursuant to an agreement under which the defendant could use the marketing concept but had to keep it confidential.[37] The plaintiffs alleged that the defendant, in breach of the agreement, had disclosed the trade secret. The defendant responded, among other things, that the plaintiffs' disclosure of the trade secret "to certain government officials acting

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[32] *See supra* note 24, at 145.

[33] *See* O'Reilley, *supra* note 23 at §14:4.

[34] *See supra* note 24, at 145-46.

[35] *See*, Annotation, *What is "Trade Secret" So As to Render Actionable Under State Law Its Use or Disclosure by Former Employee*, 59 ALR4th 641, 651.

[36] 383 F. Supp. 1135 (D.S.C. 1974).

[37] The trade secret consisted of procedures and forms to enable companies to sell life insurance that would be paid for by allotments from federal employees' salaries. Prior to the plaintiffs' developing these procedures and forms, insurance companies thought that they were blocked from selling such insurance by a statute that allows allotments only in favor of "a financial institution," the definition of which does not include insurance companies. *Id.* at 1137.

in their official capacity, to the financial institutions involved in the execution of the plan, and the necessary disclosure of the forms used in the plan to customers using the plan . . . constitutes such public disclosure as to destroy any secrecy surrounding the plan"[38] The court rejected the defendant's contention, writing:

> As to the first two groups — certain government officials and officials of financial institutions — it is clear that plaintiffs had and have the right to rely on at least a limited degree of confidentiality, inherent in dealing with such officials, to prevent their disclosing information, conveyed to them in confidence, to the public at large. . . . Such limited disclosures as these do not comport with the "complete public disclosure" which would destroy the secrecy envisioned here.[39]

By contrast, "[a]s a matter of state law, property rights in a trade secret are extinguished when a company discloses its trade secret to persons not obligated to protect the confidentiality of the information."[40] Thus, when pesticide research data was submitted to the Environmental Protection Agency, prior to the 1972 amendments to the Federal Insecticide, Fungicide, and Rodenticide Act that guaranteed confidentiality to submitters of such data, the submitters lost any property interest they might have had in the data.[41]

Trade secrets are property rights — intellectual property rights in particular.[42] As property rights, trade secrets may be the subject of civil actions arising under state common law tort or contract principles.[43] The Supreme Court has noted:

> Trade secrets have many of the characteristics of more tangible forms of property. A trade secret is assignable. A trade secret can form the res of a trust, and it passes to a trustee in bankruptcy.[44]

Since trade secrets are property rights, persons who misappropriate them may be subject to criminal prosecution under state or federal law.[45] In *Carpenter v. United States*, the Supreme Court affirmed federal mail and wire fraud convictions under 18 U.S.C. §§ 1341 and 1343 of a Wall Street Journal columnist who had divulged confidential information of the newspaper — namely the contents of his column prior to its publication. (The persons to whom he divulged the information engaged in prepublication trading of stock based on the information.) The statutes under which the columnist was charged made it illegal to obtain "money or property" by mail or wire fraud, and the issue before the Supreme Court was whether the information the columnist had divulged constituted "property." The Court

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[38] *Id.* at 1141.

[39] *Id.*

[40] *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 584 (1985).

[41] *Eli Lilly and Co. v. Environmental Protection Agency*, 615 F. Supp. 811, 820 (S.D. Ind. 1985).

[42] *See generally*, Roger M. Milgrim, Milgrim on Trade Secrets (2004).

[43] *See* Annotation, *What is "Trade Secret" So As to Render Actionable Under State Law Its Use or Disclosure by Former Employee*, 59 ALR4th 641.

[44] *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1002 (1984) (citations omitted).

[45] *See* Annotations, *Criminal Liability for Misappropriation of a Trade Secret*, 84 ALR3d 967; *Proper Measure and Elements of Damages For Misappropriation of Trade Secret*, 11 ALR4th 12.

held that it did, writing: "[c]onfidential business information has long been recognized as property."[46]

Our research was unable to locate any trade secrets cases that addressed whether or not an audit report is a protected trade secret. Therefore, with respect to DoD's disclosure of unredacted questioned and unsupported cost information in the audit report, it is unclear whether the Trade Secrets Act would apply to the disclosure of these portions of the audit report.

Trade secrets are also protected from disclosure by the Freedom of Information Act, 5 U.S.C. § 552(b)(4). The cited provision of the Freedom of Information Act exempts from mandatory disclosure by federal agencies "trade secrets and commercial or financial information obtained from a person and privileged or confidential." Much of the judicial discussion of confidential commercial and financial information – as opposed to pure trade secrets – appears to occur in the FOIA context.[47] In addition, it should be noted that many states also have freedom of information statutes.[48]

Freedom of Information Act. The Freedom of Information Act (FOIA) establishes for any person — corporate or individual, regardless of nationality — presumptive access to existing, unpublished agency records on any topic. The law specifies nine categories of information that may be exempted from the rule of disclosure. The exemptions permit, rather than require, the withholding of the requested information. Records which are not exempt under one or more of the Act's nine exemptions must be made available. If a record has some exempt material, the Act provides that any reasonably segregable portion of the record must be provided to any person requesting such record after deletion of the portions which are exempt. Disputes over the accessibility of requested records may be reviewed in federal court. Fees for search, review, or copying of materials may be imposed; also, for some types of requesters, fees may be reduced or waived.

Three of FOIA's nine exemptions from public disclosure are relevant to the issue of the permissibility of the release of allegedly proprietary data as reflected in "questioned costs" and "unsupported costs" data: exemption 1 (national security information), exemption 3 (information exempted by statute), and exemption 4 (confidential business information).[49]

FOIA Exemption 1 — National Security Information. Exemption 1 of the FOIA protects from disclosure national security information concerning the national defense or foreign policy, provided that it has been properly classified in accordance with the

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[46] 484 U.S. 19, 26 (1987).

[47] *See generally, McDonnell Douglas Corp. v. NASA,* 180 F.3d 303, 305 (D.C. Cir. 1999) (Holding that the Trade Secrets Act's scope is at least co-extensive with that of Exemption 4).

[48] *See* Annotation, *What Constitutes "Trade Secrets" Exempt from Disclosure Under State Freedom of Information Act*, 27 ALR4th 773; *see also* Annotation, *What Constitutes "Trade Secrets and Commercial of Financial Information Obtained From a Person and Privileged or Confidential," Exempt From Disclosure Under Freedom of Information Act (5 USCS § 552(b)(4))*, 21 ALR Fed 224.

[49] *See* 5 U.S.C. § 552(b)(1)(3)(4) (2005).

substantive and procedural requirements of an executive order.[50] As of October 14, 1995, the executive order in effect is Executive Order 12,958 issued by President Clinton (amended in 1999 by Executive Order 13,142, and in 2003 by Executive Order 13,292).[51] Under E.O. 12,958 information may not be classified unless "its disclosure reasonably could be expected to cause damage to the national security."[52] In this case, the documents provided to the Subcommittee were described by DoD as while "not classified, they do contain sensitive information which, if released outside the Committee, could pose a security risk to U.S. and Coalition personnel or be used to undermine Iraqi reconstruction efforts."[53] Because the unredacted questioned and unsupported costs information contained in the audit report does not appear to include classified material, Exemption 1 would appear not to be applicable.

FOIA Exemption 3 — Information Exempt by Statute. Under exemption 3 of the FOIA, information protected from disclosure under other statutes is also exempt from public disclosure.[54] Exemption 3 provides that the FOIA does not apply to matters that are:

> specifically exempted from disclosure by statute . . . provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld.[55]

Exemption 3 allows the withholding of information prohibited from disclosure by another statute only if the other statute meets any one of the three criteria: (1) it requires that the records be withheld (*i.e.*, no agency discretion); (2) it grants discretion on whether to withhold but provides specific criteria to guide the exercise of that discretion; or (3) it describes with sufficient specificity the types of records to be withheld. To support an exemption 3 claim, the information requested must fit within a category of information that the statute authorizes to be withheld. As with all FOIA exemptions, the government bears the burden of proving that requested records are properly withheld. Numerous statutes have been held to qualify as exemption 3 statutes under the exemption's first subpart — statutes that require information to be withheld and leave the agency no discretion. Several statutes have failed to qualify under exemption 3 because too much discretion was vested in the agency, or because the statute lacked specificity regarding the records to be withheld. Unlike other FOIA exemptions, if the information requested under FOIA meets the withholding criteria of exemption 3, the information must be withheld.

The Trade Secrets Act[56] is often asserted to be an Exemption 3 withholding statute, despite legislative history and court holdings to the contrary. The Trade Secrets Act is a criminal provision which generally proscribes the disclosure of trade secrets and confidential

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[50] 5 U.S.C. § 552(b)(1) (2005).

[51] 3 C.F.R. 333 (1996), *reprinted in* 50 U.S.C. § 435 note.

[52] Exec. Order No. 12.958, § 1.2(a)(4).

[53] Letter from Powell A. Moore, Assistant Secretary of Defense for Legislative Affairs, Department of Defense, to Honorable Christopher Shays, Chairman Subcommittee on National Security, Emerging Threats and International Relations (November 15, 2004).

[54] 5 U.S.C. § 552(b)(3) (2005).

[55] 5 U.S.C. § 552(b)(3) (2005).

[56] 18 U.S.C. § 1905 (2005).

business information by a federal officer or employee "unless otherwise authorized by law." The legislative history indicates that when Congress revised Exemption 3, it indicated that it did not consider the Trade Secrets Act to be withholding authority within the exemption's scope.[57] The Supreme Court in *Chrysler v. Brown*,[58] suggested that the Trade Secrets Act may indeed be an independent basis to force withholding of access to agency records. Nevertheless, more recent court decisions have rejected the contention that the Trade Secrets Act is an Exemption 3 statute.[59]

FOIA Exemption 4 — Confidential Business Information. Exemption 4 of FOIA exempts from disclosure "trade secrets and commercial or financial information obtained from a person and privileged or confidential."[60] Executive Order 12,600 (*Predisclosure Notification Procedures for Confidential Commercial Information*) requires each federal agency to establish procedures to notify submitters of confidential commercial information whenever an agency "determines that it may be required to disclose" such information under the FOIA.[61] The submitter is provided an opportunity to submit objections to the proposed disclosure.[62] If the agency decides to release the information over the objections of the submitter, the submitter may seek judicial review of the propriety of the release, and the courts will entertain a "reverse FOIA" suit to consider the confidentiality rights of the submitter.[63]

According to a leading commentator, "by adopting the 'trade secret' term, Congress imported into the Freedom of Information Act interpretations many years of judicial gloss upon a legal term of art."[64] In *Public Citizen Health Research Group v. FDA*, the D.C. Circuit expressly rejected "the broad Restatement approach. . . . as inconsistent with the language of the FOIA and its underlying policies."[65] Under the Restatement definition of a trade secret, any compilation of business information which provides competitive

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[57] *See* H.R. Rep. No. 880, 99th Cong., 1st Sess., 23 U.S. Code Cong. & Admin. News 2183, 2205 (1976).

[58] 441 U.S. 281, 301-16 (1979).

[59] *See generally, CNA Financial Corp. v. Donovan*, 830 F.2d 1132, 1137-41 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 977(1988). (noting that the Trade Secrets Act "appears to cover practically any commercial or financial data collected by any federal employee from any source" and that the "comprehensive catalogue of items" listed in the act "accomplishes essentially the same thing as if it had simply referred to "all officially collected commercial information" or "all business and financial data received") It can also be noted that section 41 U.S.C. § 423 proscribes the disclosure of procurement information (contractor bid or proposal information or source selection information) before the award of a Federal agency procurement contract to which the information relates by a present or former official of the United States, or a person who is acting or has acted for or on behalf of, or who is advising or has advised the United States with respect to a Federal agency procurement and by virtue of that office, employment, or relationship has or had access to contractor bid or proposal information or source selection information.

[60] 5 U.S.C. § 552(b)(4) (2005).

[61] 3 C.F.R. 235 (1988), *reprinted in* 5 U.S.C. § 552 note.

[62] Exec. Order No. 12,600, § 4 (1987).

[63] *Lee v. FDIC*, 923 F. Supp. 451, 455 (S.D.N.Y. 1996).

[64] *See* O'Rielly, *supra* note 23 at § 14:4.

[65] *Public Citizen Health Research Group v. FDA*, 703 F.2d 1280, 1288 (D.C. Cir. 1983).

advantage constitutes a trade secret and would be entitled to per se protection in FOIA cases. For FOIA purposes, the D.C. Circuit held that the term "trade secret" should be limited to mean:

> a secret, commercially valuable plan, formula, process, or device that is used for the making, preparing, compounding, or processing of trade commodities and that can be said to be the end product of either innovation or substantial effort.[66]

Although the *Public Citizen* definition is limited to information which relates directly to the production process,[67] under either definition the information must be: (1) commercially valuable; (2) used in one's business; and (3) maintained in secrecy. In general, the Restatement definition of a "trade secret" is the definition applied by courts in the absence of a more specific statute.

When a federal court considers a trade secret exemption claim in a disclosure case, it must determine the state law on trade secret status which guides the federal decision under *Erie R. Co. v. Tompkins*.[68] If the statute of the forum state provides protection for trade secrets, then the forum law governs the construction of the term contained in the Freedom of Information Act.

To fall within the second category of exemption 4, commercial or financial information obtained from a person that is privileged or confidential, the information must satisfy three criteria. It must be: a) commercial or financial; b) obtained from a person; and c) confidential or privileged.

The D.C. Circuit has held that the terms "commercial or financial" should be given their ordinary meaning, and that records are commercial if the submitter has a "commercial interest" in them.[69] The second criteria, "obtained from a person," refers to a wide range of entities.[70] However, information generated by the federal government is not "obtained from a person," and as a result is excluded from exemption 4's coverage.[71] In a 1999 ruling in *Philadelphia Newspapers, Inc. v. Department of Health and Human Services*[72] the United States District Court for the District of Columbia was faced with a request for disclosure of an audit report. In *Philadelphia Newspapers*, the information sought was contained in an

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[66] *Id.* The Tenth Circuit has adopted the *Public Citizen* test. *See Anderson v. HHS*, 907 F.2d 936, 944 (10th Cir. 1990).

[67] *See, e.g., AT&T Information Systems v. GSA*, 627 F. Supp. 1396, 1401 n. 9 (D.D.C. 1986)(parties in a reverse FOIA action agreed that "this narrow definition excluded pricing information submitted by plaintiff in successful bid for government contract").

[68] 304 U.S. 64 (1938); *see also Burlington Northern R. Co. v. Omaha Public Power Dist.*, 888 D.2d 1228 (8th Cir. 1989).

[69] *Public Citizen Health Research Group v. FDA*, 704 F.2d 1280, 1290 (D.C. Cir. 1983).

[70] *See, Nadler v. FDIC*, 92 F.3d 93, 95 (2d Cir. 1996)(term "person" includes "individual, partnership, corporation, association, or public or private organization other than an agency" (quoting definition found in Administrative Procedure Act, 5 U.S.C. § 551(2)).

[71] *See Allnet Communications Servs. v. FCC*, 800 F. Supp. 984, 988 (D.D.C. 1992).

[72] *Philadelphia Newspapers, Inc. v. Dep't of Health and Human Services*, 69 F.Supp.2d 63 (D.D.C. 1999).

audit prepared by the Department of Health and Human Services (DHHS) seeking to determine, as part of a fraud investigation, a teaching hospital's Medicare billing error rate.[73] DHHS attempted to assert FOIA exemption 4 by arguing that, while in fact the auditor created most of the documents at issue, the information contained was nevertheless obtained directly from the hospital's business records and, as such, was entitled to protection from disclosure as confidential business records.[74] The court rejected this argument, noting that this case could be distinguished from cited precedent because what was being sought was not "a government contractor's 'actual costs for units produced,' 'actual scrap rates,' 'break-even point calculations,' and 'actual cost data,'" but rather an analysis and conclusions prepared by the government auditor.[75] Thus, the court was able to conclude that not only was the information sought "not obtained from a person" as the exemption requires, but also that an audit is "not simply a summary or reformulation of information supplied by a source outside the government," and, therefore, may not be withheld pursuant to FOIA exemption 4.[76]

Most Exemption 4 cases have involved the third criterion, whether the information was "confidential." In 1974, the D.C. Circuit in *National Parks and Conservation Association v. Morton*, held that the test for confidentiality was an objective one.[77] It held that neither the fact that a submitter would not customarily make the information public, nor an agency's promises of confidentiality was enough to justify confidentiality. *National Parks* enunciated a two-part test: commercial information is confidential "if disclosure of the information is likely to have either of the following effects: (1) to impair the government's ability to obtain necessary information in the future; or (2) to cause substantial harm to the competitive position of the person from whom the information was obtained."[78] These are commonly referred to as Test 1 and Test 2.[79]

In 1992, in *Critical Mass Energy Project v. NRC*,[80] after examining arguments in favor of overturning *National Parks,* the D.C. Circuit reaffirmed application of the *National Parks* test based on the principle of *stare decisis* — which counsels against overruling established precedent. The plaintiff in *Critical Mass* was seeking reports which a utility industry group prepared and gave voluntarily to the NRC. The agency did, however, have the authority to compel submission. The full Circuit Court of Appeals clarified the scope and application of the *National Parks* test. The court limited its application "to the category of cases to which [they were] first applied; namely those in which a FOIA request is made for commercial or

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[73] *Id.* at 65.

[74] *Id.* at 66-67.

[75] *Id.* at 67 (citing *Gulf & Western Indus. v. United States*, 615 F.2d 527, 530 (D.C.Cir.1979)).

[76] *Id.*

[77] 498 F.2d 765 (D.C. Cir. 1974).

[78] *Id.* at 770.

[79] *See Niagara Power Corp. v. United States Department of Energy*, 169 F.3d 16 (D.C. Cir. 1999)(court held that material fact existed as to whether disclosure of fuel consumption and power generation figures provided pursuant to statute would impair agency's ability to collect information, and whether disclosure was likely to cause plants substantial harm).

[80] 975 F.2d 871, 879-80 (D.C. Cir. 1992)(*en banc*)(*"Critical Mass II"*), *cert. denied*, 113 S. Ct. 1579 (1993).

financial information a person was obliged to furnish to the Government."[81] The court established a new test for confidentiality when the information is submitted voluntarily; the information is exempt from disclosure if the submitter can show that it does not customarily release the information to the public.[82] Under the *Critical Mass* decision, one standard (the traditional *National Parks* tests) applies to any information that a submitter "is required to supply," while a broader exemption 4 standard (a new "customary treatment" test) applies to any information that is submitted to an agency on a voluntary basis. The burden of establishing the submitter's custom remains with the agency seeking to withhold the records. Applying the customary treatment test to the information at issue (utility industry group reports voluntarily submitted), the D.C. Circuit agreed with the district court's conclusion that the reports were commercial; that they were provided to the agency on a voluntary basis; and that the submitter did not customarily release them to the public. Thus, the reports were found to be confidential and exempt from disclosure under exemption 4.

The key issue raised by *Critical Mass* is the distinction between "required" and "voluntary" information submissions. In its decision, the court did not expressly define the two terms. The Department of Justice has issued policy guidance on the distinction between required and voluntarily information submissions, and has taken the position that the submission of records in instances such as the bidding on government contracts is mandatory rather than voluntary.[83] Nonetheless, the *Critical Mass* voluntary versus required standard has not been widely adopted by the other circuits that have endorsed the *National Parks* test.

In conclusion, should a member of the general public make a FOIA request seeking disclosure of the DCAA audit report relating to Task Order No. 5,[84] it would appear that, at least with respect to the analysis and conclusions prepared by the government auditors, such information would not be protected from disclosure by exemption 4 because the conclusions

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[81] *Id.* at 880.

[82] *Id.* at 879.

[83] *See FOIA Update*, Vol. XIV, No. 2, at 3-5 ("OIP Guidance: The Critical Mass Distinction Under Exemption 4"). The basic principles developed by the Justice Department are that a submitter's voluntary participation in an activity does not determine whether any information submission made in connection with that activity is "voluntary;" that *Critical Mass* determinations should be made according to the circumstances of information submission; that information submissions can be "required" by a range of legal authorities, including informal mandates that call for the submission of information as a condition of dealing with the government or of obtaining a government benefit; and that the existence of agency authority to require an information submission does not automatically mean that the submission is "required." *Id.; see, e.g., Center for Auto Safety v. National Highway Traffic Safety Admin.*, 93 F. Supp.2d 1 (D.D.C. Feb. 28, 2000), *remanded by Center for Auto Safety v. National Highway Traffic Safety Admin.*, 244 F.3d 144 (D.C.Cir. Mar. 30, 2001); *Lee v. FDIC*, 923 F. Supp. 451, 454 (S.D.N.Y. 1996).

[84] *See* 32 C.F.R. § 290.7(b) (2004) (stating that "[a]udit reports prepared by DCAA are the property of and are prepared for the use of DoD contracting officers. As a result, their release should be at the sole discretion of the DoD contracting activity."); see also DCAA Freedom of Information Act Processing Guide, DCAA Pamphlet 5410.14, 18 *available at*, http://www.dcaa.mil/dcaap5410.14.doc (including a heading entitled "What is the Procedure for Handling Audit Reports Subject to the FOIA").

and analysis would likely be considered "from the government" and not obtained "from a person" as required.[85]

[85] *Philadelphia Newspapers,* 69 F.Supp.2d at 67; *see also Fisher v. Renegotiation Bd.,* 355 F.Supp 1171, 1174 (D.D.C. 1973) (holding that information sought in connection with certain government contracts concerning business sales, costs, profits, and other financial records were distinguishable from agency documents which reflected the agency's own conclusions as to the amount of excess profits earned by the contractors. According to the court, conclusions relating to excess profits were based on an application of the agency's own accounting analysis as applied to the information submitted by the contractors, and, therefore, was held to be information from the government and not exempt from disclosure under FOIA exemption 4).

Mr. SHAYS. I would just also say to our panelists, if you have not been asked questions to which you would like to make a comment, feel free to ask the question or whether you can jump in. And if there is anything in the end that you want to put on the record, you will be given time, so take notes on anything you want to share so it is part of the record, because some of you are being asked more questions than others and it may be that you need to put something in the record. So, one, feel free to jump in to see if you can respond with your information, and, two, if you choose not to do it then, at least at the end we will give you time to respond and make any last comments.

At this time the Chair would recognize Mrs. Maloney.

Mrs. MALONEY. I thank the chairman for really his leadership on this issue and so many others. I must compliment Henry Waxman on this report on the mismanagement of Iraqi funds, although I must say that I find the contents absolutely sickening—107 million U.S. dollars, $100 bills shipped to Iraq, but that is peanuts compared to the $8.8 billion missing in the CPA and the abuse in the commander's fund I find incredibly troubling in your report, and I thank you very much for your report.

The records that we have received show that $637 million in Iraqi funds was given out in four regions to local commanders and officials that they could use it in short-term projects for rebuilding hospitals and roads, employing the Iraqi people, and helping people, and helping the region.

I met with General Patrias in Mosul and was very impressed with the projects that he had initiated and that he was helping the Iraqi people, but your report shows, Mr. Bowen, that a great deal of this money did not get to the people or to the purpose that was intended, and I'd like to ask you: is it correct, when you looked at one region that received about $120 million in these commander's emergency funds, you could not account for $96 million of it? In other words, more than 80 percent of the cash, that there were no clear records whatsoever? Is that correct from your report?

Mr. BOWEN. Let me make a distinction for you. There are two different programs for rapid reconstruction, or there were at that time in Iraq. One was the CERP, the commander's emergency response program, and the other was the R3P, the rapid reconstruction response program. Our audit addressed the latter one, not the CERP.

We have an audit ongoing of the CERP and that will be out in our October report, and you are right to ask questions about it, but also your point is well taken on the effectiveness of it. I think there were some real lessons learned as to how CERP has been executed as far as what is effective for rapid reconstruction.

In Hillah, which is a town in south-central Iraq, there was a DFI funds director who had responsibility for $120 million you referred to. He failed in many ways in managing those funds. There were $89 million that were not properly receipted. There were four levels of keeping track of money. He failed at least one or all of those levels in tracking $89 million, and with respect to $7 million there is no record. Also, as I alluded to earlier——

Mrs. MALONEY. So $7 million there is no record and $89 million was misused or unaccounted for?

Mr. BOWEN. Inadequate receipts or——

Mrs. MALONEY. Unaccounted for.

Mr. BOWEN [continuing]. Documentation. That is correct.

Mrs. MALONEY. OK. So $89 million unaccounted for and $7 million absolutely missing?

Mr. BOWEN. That is correct.

Mrs. MALONEY. That is a disgrace beyond words. In your report you stated that you discovered obviously from your comments today fraud, and that you were initiating a criminal investigation. Can you tell us about this investigation?

Mr. BOWEN. I cannot give you the details of those investigations, but they are ongoing.

Mrs. MALONEY. But could you tell us broadly what those officials are accused of and how you detected the fraud in a broad sense?

Mr. BOWEN. In the broadest terms, this was a story of auditors and investigators working well together in Hillah, auditors bringing to my attention indicators of potential fraud, the deployment of investigators down that money trail, and the resulting cases that were developed had been presented to the U.S. attorney.

Mrs. MALONEY. So you have presented how many cases to the U.S. attorney?

Mr. BOWEN. On these issues, three.

Mrs. MALONEY. And are you talking about the eastern district or——

Mr. BOWEN. Yes, ma'am.

Mrs. MALONEY. OK. When did you present it to the eastern district?

Mr. BOWEN. Within the last 2 weeks.

Mrs. MALONEY. And I understand the audit that we have been referring to and you mentioned is in the south-central region of Iraq?

Mr. BOWEN. That is right.

Mrs. MALONEY. Also, aside from that $120 million, by my calculation there is more than roughly $400 million went to the other three regions. Are you auditing them, also?

Mr. BOWEN. Of the R3P programs we do not have an ongoing audit of those other regions. Now, we have four audits going on still in this region. We are looking at two projects, the——

Mrs. MALONEY. So you are talking about the south-central region——

Mr. BOWEN. Yes.

Mrs. MALONEY [continuing]. You have all these audits going on?

Mr. BOWEN. That is correct.

Mrs. MALONEY. But there are three other regions. Are you going to audit the other three regions?

Mr. BOWEN. It is a question of resources right now. Our mission now, as assigned by Congress, is to focus on the Iraq rehabilitation and relief fund, which is the taxpayer appropriated dollars, and my limited resources are being devoted toward performance audits of the projects being accomplished with the IRF.

Mrs. MALONEY. Well, I, for one, think you should be given the funds to do your job and I compliment you on your work.

Mr. BOWEN. Thank you.

Mrs. MALONEY. It is an important position, and you have done a great service to the American taxpayers. I, for one, deeply appreciate it.

I'd like to ask Mr. Reed, is DCAA looking into any of these commander's emergency funds and how they were spent? Are you investigating it at all?

Mr. REED. No, we are not. Our mission involves the audit of——

Mrs. MALONEY. That is my question is whether you are investigating it. I'd like to——

Mr. SHAYS. But if he could just explain——

Mrs. MALONEY. If you will give me additional time, that would be great.

Mr. SHAYS. Let me just say you only had 10 seconds left anyway, but just explain why he's not so we——

Mr. REED. Our mission is to do contract audits involving contracts which require audits to set the price or to reimburse the cost.

Mrs. MALONEY. OK. But if he's not investigating it, I'd like to know is Mr. Norquist in the comptroller's office, are you investigating and examining this spending, and likewise Mr. Benkert, is the DSO auditing these expenditures.

Mr. NORQUIST. Not to my knowledge. I do not belong to an organization that—as the observer to the IAMB, I would not have been involved in that.

Mr. BENKERT. My office does not do these sorts of audits, but let me just say I think there are—and Mr. Bowen's quarterly report indicates this—there are a number of audits that either are ongoing or will be done of the commander's emergency response program. The audit he has done—I believe there were other audits too—it is included in his quarterly report, a listing of these audits.

I would also point out that there are, I believe, eight audit agencies and inspectors general operating in Iraq in auditing aspects of Iraq reconstruction who have so far produced over 1,500 audit reports, many of those from DCAA. So there is a very extensive audit program that is going on as part of the management of Iraq reconstruction.

Mrs. MALONEY. But my point and my question, if I could, Mr. Chairman, was directed to the $400 million that Mr. Bowen says he cannot have the resources to look at at this point. The other three——

Mr. SHAYS. I'd suggest to the gentlelady that she will have a second round to——

Mrs. MALONEY. But the gentlemen say they are not looking at it. I am just saying that is a lot of money. Someone should be looking at it. I think it is an important program, but if there is a waste, fraud, and abuse of these dollars, Mr. Bowen has already referred three people to the eastern district court system, and I think that the other $400 million should likewise be audited, and from their testimony no one is doing that now.

Mr. SHAYS. Let me just clarify. Is no one doing it now? I am confused by that.

Mr. BOWEN. We are auditing the CERP program and that is $600 million and that is nationwide. With respect to the R3P, I do not know if the other regions' allocations of R3P are being audited.

Mr. SHAYS. Could you provide that information back to the committee?

Mr. BOWEN. Yes, sir.

Mr. SHAYS. And we will get back to Mrs. Maloney on that.

Mr. BOWEN. Yes, sir.

Mr. SHAYS. I hope there is someone taking notes on what you all are going to get back to us.

Mr. BOWEN. Yes, right here.

Mr. SHAYS. Mr. Sanders, you have the time.

Mr. SANDERS. Thank you very much.

Mr. SHAYS. Thank you for your patience, Mr. Sanders.

Mr. SANDERS. Thank you very much, Mr. Chairman. And let me congratulate you for holding this hearing. This committee has an enormously important responsibility, regardless of who the President of the United States is, and that is to provide oversight to make sure that, among other things, taxpayers get their dollar's worth and that our Government runs in the way it should be running, and I must say that since George Bush has been President this committee has in many ways abdicated its responsibility and not had the kind of hearings that it should be having.

I can recall that under Bill Clinton we had hearings every other day for every other reason, and yet on some of the most important issues of concern to the American people this committee has not been active, so I want to applaud you for delving into an issue that obviously is a concern to the American people.

The war in Iraq is controversial. This country has a huge deficit. This week we will be debating on the floor of the House cuts in very important programs for low income and moderate income Americans. I think, regardless of one's position on the war, there is no American that does not believe that every dollar that we spend or that we budget for Iraq should be spent in a way that improves the lives of the Iraqi people and that does not disappear in thin air. I do not think there is any disagreement on that.

In looking over this report, there are just some statements here that almost defy imagination, and I speak as someone who was a mayor of a city for 8 years and has some administrative experience.

I would just ask any member of the panel to please help me out and provide additional information on some of these issues.

The assertion is that American officials frequently exercise poor or nonexistent oversight over contracts funded with hundreds of millions of dollars from Iraqi proceeds. We found six cases where contracting files could not be located which involved disbursements of over $51 million. Explain to me. I am not quite sure what that means—contracting files could not be located.

I am a mayor. I sign you off as a vendor. We sign a contract. We put it away some place. That is usually the way business is done. What does that mean that contracting files could not be located, Mr. Bowen?

Mr. BOWEN. Quite literally what you have just said. We did two contract audits—that is, audits of the processes—in Baghdad of how contracts were let both under the DFI and using appropriated funds, and in both audits we had findings that criticized the procedures.

As you noted, in both cases there were situations where we just randomly asked for a set of contracts, and in those situations there were some that they simply could not put their hands on, and there were——

Mr. SANDERS. You could not find the document?

Mr. BOWEN. Yes, sir. That is right.

Mr. SANDERS. Well, how does one disburse money for services without a document that tells us how much you are paying for what you are supposedly getting?

Mr. BOWEN. Well, these were completed contracts, so the disbursements had occurred. But, nevertheless, that is not an excuse. I am just saying——

Mr. SANDERS. They were completed but you did not see it?

Mr. BOWEN. No, no. The fact of the matter was we asked for contracts that were completed. We wanted to go back and look through their files.

Here's the issue. There was substantial turnover within CPA—still is. We are hitting the 1-year mark in Baghdad since the State Department took over, and guess what, they are all on 1-year tours. There is significant turnover occurring. I am not ascribing the same set of problems to the State Department that we identified in those two audits, but what I am saying is that personnel turnover resulted in a lack of continuity.

Frequently a contract officer would use in charge of a set of contractors, his or her replacement would follow on weeks later, and there was just a complete drop informationally. Sometimes they were on stick, memory sticks, or there were not adequate procedures, as we identified.

Here's a lesson learned. What do we need to do in situations like that? We need to have a single repository of contracting data like you were referring to when you were mayor. You know, you had one place you could go and find out about all the contracts of your city. That is what we need to do. I mean, it is common sense.

Mr. SANDERS. This is kind of an A,B,C of governmental processing, would not one think?

Mr. BOWEN. But at the same time we were in the middle of a massive insurgency in a wartime situation with significant turnover and unique situations that simply do not compare domestically.

Mr. SANDERS. I appreciate it. But let me ask another question of anybody——

Mr. REED. Could I add to that?

Mr. SHAYS. Please, Mr. Reed.

Mr. REED. I think it is important to note that in my opening statement I mentioned that DCAA is actively involved in providing contract audit oversight on some 14 contracts or 16 contracts totaling $3 billion. These are awards to U.S. firms that contain the proper normal audit clauses that we operate with, and they are going to be very effectively audited.

Mr. SANDERS. Good. There is another assertion here that over 600,000 tons of Iraqi oil worth $69 million produced between June 29, 2004, and December 31, 2004, is missing. We simply have lost 600,000 tons of oil. Anyone have any thoughts about where we might locate 600,000 tons of oil? Mr. Benkert.

Mr. BENKERT. Mr. Sanders, as you know, since June 28th the production of oil and the complete operation of the oil industry is an Iraqi responsibility. I mean, it is a sovereign country. This missing oil was reported by an audit that KPMG did on behalf of the IAMB that covered this period after the U.S. transferred sovereignty to the Iraqis. So this took place after the U.S. transferred responsibility to the Iraqis and before the end of the year.

What the auditor found was, in looking at the records of the Ministry of Oil and the financial records associated with the Development Fund for Iraq, that they could not account for that much oil. And they have referred this matter to the Iraqi government.

Mr. SANDERS. OK. Thanks for the explanation. But am I correct in asserting that is, everything being equal, money that should have gone back to the Iraqi people to rebuild their country?

Mr. BENKERT. Yes, sir, you are correct. That is money that should have been, if it was properly accounted for, if those oil sales were properly accounted for, that money should have been deposited into the Development Fund for Iraq, which of course now funds the Iraqi budget.

Mr. SANDERS. Right. So that investigation is ongoing but at this point we have not located that $69 million; is that correct?

Mr. BENKERT. As I said, this is a matter that is between the auditor, the IAMB, and the Iraqi government. To the best of my knowledge, it has not been resolved.

Mr. SANDERS. OK. Mr. Chairman, thank you again. And let me again—I think this is a very important hearing, and I hope that we can continue to hold hearings like this. Thank you very much.

Mr. SHAYS. Thank you. And I appreciate the conduct of the Members in just trying to get at the truth.

At this time the Chair would recognize my friend from Boston.

Mr. LYNCH. Thank you, Mr. Chairman. I want to add my support, as well. I think this is a long overdue hearing and I think that this whole process of trying to get to the bottom of the misallocation or theft of up to $20 billion here—just as a sidebar, I know we have put off at least for a week the discussion of whether subpoenas should be issued for our further hearings. I just want to weigh in publicly and say that I think the time for subpoenas has long since passed, and I think the amount of waste, fraud, and abuse that we have here on the American taxpayers is a disgrace. I think we have seen enough foot-dragging in this instance to warrant subpoenas to get some people to come forward.

Mr. Bowen and Mr. Reed—Mr. Reed, we have spoken before in these hearings—I realize that a lot has been said that this is a wartime exercise in terms of trying to work with these programs for the Oil-for-Food Program and Iraqi reconstruction, but we recently had a situation where a Halliburton procurement manager, Jeff Maison, and a general manager of the Halliburton subcontractor, Ali Hajazi, were eventually finally indicted for a kickback scheme, and it involved overcharging by the subcontractor of about $4 million and $1 million going to the Halliburton manager in repayment. We have an indictment there.

This involved a Kuwaiti company called LaNovele. Now, LaNovele has dozens and dozens, maybe over hundreds of contracts not only with troop support contract but also with reconstruction

and relief. Have we gone back—given the fact that indictments have come down in this case, have we gone back and checked out every contract that LaNovele has been involved in and Ali Hajazi and Jeff Maison to find out whether or not, since they were involved in a kickback scheme in this one instance and they are under indictment, have we looked at other activity across Iraq to determine whether this was the standard procedure and practice for this company and whether there is an extensive involvement here on the part of these individuals?

Mr. REED. On DCAA's part, of course, any time we see an abuse like this and it is found to actually exist and we get indictments and convict, to any auditor that becomes an immediate——

Mr. LYNCH. I am sorry, Mr. Reed, is your mic on? We want to catch it all.

Mr. REED. It is on and I am talking as loud as I can here, sir.

Mr. LYNCH. I am sorry.

Mr. REED. I will talk even louder.

Mr. LYNCH. I appreciate it.

Mr. SHAYS. Let me just say some of the mics seem to work better than others, because you are pretty close to it. But just start over again. We will give the gentleman a little more time here.

Mr. LYNCH. Thank you.

Mr. REED. Yes, we are auditing all contracts awarded to Novele, and not only Novele but any contractor over there, I believe in this particular environment, from a fraud assessment standpoint in terms of what an auditor might use to decide how much auditing to do and in what areas, we are very aware of the risk in this environment and so yes, we are looking at other contracts.

As far as this particular investigation, I have to presume, because I do not have the details of the investigation, itself, but it is normal in an investigation of that type that the investigators would follow that lead wherever it took them, including all other contracts that these people touched.

Mr. LYNCH. All right. That is your assumption. OK. Maybe we have to followup with that in future hearings.

I do want to say that, with respect to the Pentagon auditing, the DCAA Government audits, we have had six task orders on the restoration of Iraqi oil, RIO, contracts performed by Kellogg, Brown and Root, and they were funded with DFI funds. Five involved fuel import and distribution, and there have been a total of 14 audit reports, and additional advice letters from DCAA on these task orders.

We received the reports, themselves; however, the Defense Department redacted much of the reports. The redacted information was considered to be proprietary information. I'd like to know from any of the panelists who made the decision to withhold as proprietary business information all the figures on questions and unsupported costs as determined by the DCAA auditors, and what is the legal justification for withholding that information from Congress?

Colonel DUBOSE. Sir, the redactions were made by KBR, and that was based on their assertion that it was proprietary data protected by the Trade Secrets Act.

Mr. LYNCH. Colonel, under the circumstances here, given what we know is going on here in large part with Kellogg, Brown and

Root and Halliburton, what is the legal justification for withholding the information from Congress?

Colonel DUBOSE. Sir, it is not the Corps' assertion that information would be withheld from Congress. It was in response to the request from the IAMB, sir.

Mr. LYNCH. I am sorry? Can you repeat? I cannot quite hear you.

Colonel DUBOSE. Sir, the redaction was made in response to the request to provide those to the IAMB. I do not believe the Corps has any problem with those unredacted audits being provided to Congress or anybody in the U.S. Government.

Mr. LYNCH. So we are in agreement here? Congress should get the unredacted reports in this instance? I just want to get this on the record, sir.

Mr. SHAYS. Let me—if the gentleman would yield, we do have the unredacted version. We were given that in March. But the issue is why did—this is not off the gentleman's time—the issue is why did not the U.N. basically get this information. We treated it almost like the U.N. was a FOIA request and the attorneys responded that way, and I would suggest that the U.N. had as much right to have this information as Congress, frankly, and that is what I will get around to in my questions.

I realize, Mr. Benkert, this was not your decision, correct? You did not make the decision to redact; is that correct?

Mr. BENKERT. Yes, sir, that is correct. I mean, I became the liaison to the IAMB after this information was provided.

Mr. SHAYS. OK. Let me—I am sorry. The gentleman has more time. The gentleman has about a minute left or two, whatever he'd like.

Mr. LYNCH. Thank you, Mr. Chairman. I appreciate that.

In your estimation collectively, are there obstacles that you are finding in terms of being able to provide information to the Congress regarding money that was misspent, misallocated? Are there safeguards that you would recommend either to help the transparency within the programs or that would enhance the ability of yourselves and of Congress to track, as Mr. Ruppersberger said earlier, following the money?

Mr. REED. I do not believe there is barriers. The Department's policies and procedures are to be cooperative with Congress and to provide information requests. Where we have provided audit reports in the past to Congress, we do note the restrictions on the reports just so they will be aware that they may contain sensitive information. So from my viewpoint there are no barriers.

Mr. LYNCH. Thank you. I yield back. Thank you, Mr. Chairman.

Mr. SHAYS. Thank you. Mr. Kucinich, I have some questions, but I would prefer that you go. I am going to kind of close up, so do you have questions you'd like to ask?

Mr. KUCINICH. Yes, I do.

Mr. SHAYS. Thank you, Mr. Lynch, for your questions.

Mr. LYNCH. Thanks. Thanks, Mr. Chairman.

Mr. KUCINICH. Doing the math on the fact that 107 million $100 bills were transferred from New York to Baghdad, this information provided by staff, if that is correct we are talking about $10.7 billion in $100 bills. Mr. Bowen, is that essentially correct?

Mr. BOWEN. That sounds like a number I have heard regarding the flights.

Mr. KUCINICH. Now, up here on the screen this is a photo, according to information given to me by staff, taken in July 2003, in Baghdad. What's pictured here is 20 packages of $100,000 each. These are $100 bills. The individuals holding this cash are Coalition Provisional Authority officials. The man in the middle is Frank Willis, who is a deputy senior advisor at that point for the Ministry of Transportation and Communications. His boss, Darryl Trent, is on the right. According to information provided by staff, I am being told that this is $2 million in cash paid, according to Frank Willis, to Custer Battles. Again according to Mr. Willis, the company was told to bring a big bag for payment.

I offer this, Mr. Bowen, for your consideration as you begin to look at the manner in which things were disbursed and to whom. Custer Battles is a U.S. contractor.

Mr. Bowen, do you know how many private contractors there are in Iraq right now? Do you have any idea?

Mr. BOWEN. We have developed a data base that is tracking who has received contracts in Iraq, so yes, we have that information.

Mr. KUCINICH. Can you give the committee a number?

Mr. BOWEN. I will have to provide that number for you. I do not want to ballpark it right now.

Mr. KUCINICH. Is it possible that it could be more than 5,000?

Mr. BOWEN. We will just have to get back to you with that specific number, but we have—the data base I referred to earlier is developed precisely to answer these types of questions, so we can get that for you.

Mr. KUCINICH. While you are developing the data base—I'd like to ask the Chair's indulgence here, Mr. Chairman. The thing that interests me is I am looking at—I looked earlier at cash packs on the earlier screen. Could you bring up one of those? Could staff bring up one of those cash packs on the screen? Now, remember we are talking about $10.7 billion in $100 bills. These cash packs came through the Federal Reserve.

Now, it seems to me that $100 bills, as with all money, have serial numbers on them, correct, Mr. Bowen?

Mr. BOWEN. That is correct.

Mr. KUCINICH. Is any effort being made to follow the money, literally, to try to determine if any of these $100 bills have found their way back through the currency system back to the United States to determine where they are located? Is anyone even asking that question about where's the money, where is the money going, where is it, has it turned up anywhere? Has any effort been made to see where those $100 bills are showing up?

Mr. BOWEN. Yes. U.S. Customs has been notified about this and we have worked with them. On specific case through our investigators we have had bags searched and we have stopped people both at the Baghdad Airport and we have had Customs agents meet them at airports as they have landed here and go through their belongings. But you are asking a really big question about a billion-dollar question so to speak, and——

Mr. KUCINICH. Actually, it is a $10.7 billion question.

Mr. BOWEN. Yes, you are right. And so you have to understand sort of what types of money and where this money went and what's the jurisdiction over it now. I think those are important questions.

Mr. KUCINICH. Is it within your jurisdiction to provide this committee with the serial numbers that came through Federal Reserve—I take it these were new $100 bills—to provide this committee with the information with respect to any list on which those serial numbers have turned up on coming back through Customs, who held those serial numbers? Do we have that?

Mr. BOWEN. No, we do not. And we have not—the measures that I have described have not produced findings, so to speak.

What this money was used for that you see on this slide, this is DFI money. This money was used to fund the new Iraqi government and to fund contracting that they did, to capital projects, to pay salaries—what I addressed in my controls audit report. The issue with respect to fraud may have occurred regarding that contracting or those payments are potential Iraqi crimes. In other words, that is what I was referring to that Judge Roddy, who is the Commissioner of Public Integrity and, indeed, the Fiscal Integrity Commission within the Iraqi government, the Board of Supreme Audit, and the IGs all have audits and investigations connected to how that money was used.

Mr. KUCINICH. Well, let me ask you this. Any of this—are U.S. contractors or anyone who is a U.S. citizen who comes into contact with any of the cash in Iraq, are they covered by U.S. law?

Mr. BOWEN. You have raised a good question. We are treating the—I treat that as a yes. If we uncover information with respect to a contractor who has misappropriated or fraudulently expropriated DFI dollars, then we will pursue that as a U.S. crime.

Mr. KUCINICH. Mr. Chairman, I am going to wrap up right now, but I just think that as the committee gets into this subject it would be of great interest to determine how that money is coming back to the United States at some point—since we are talking about cash here, which does represent a note that is legal tender—at some point that money has to find its way back to the United States. If we are looking at the potential for fraud here or any kind of corruption it might be instructive to this Congress to make such a determination about where the money is coming from and, in effect, to follow the money.

Mr. BOWEN. And I am trying to follow the money. You have put your finger on an exceedingly large difficulty with respect to tracking funds in Iraq. There is no forensic electronic trail with respect to how this money was used.

Just so you know and without getting specific, I am using the tools at my disposal this side of the world to track those issues.

Mr. KUCINICH. Thank you, Mr. Chairman.

Mr. SHAYS. I thank the gentleman. I thank you, Mr. Bowen, as well.

Mr. Lynch, if you have questions then I will end up and we will get to the next panel. I am going to go last, but you are more than welcome to ask questions if you have them.

Mr. LYNCH. Thank you, Mr. Chairman. Just 1 second.

Mr. SHAYS. Take your time.

Mr. LYNCH. Thank you, Mr. Chairman. We just have one thing we want to get on the record here. We have been trying to track here the flow of taxpayer dollars and also the funds that have been directed for this purpose of reconstruction. I'd like to ask some questions about the last-minute spending rush in the final days and weeks of the Coalition Provisional Authority's existence.

The report by Representative Waxman's staff has already been made part of the record, but it details how nearly half of the currency shipped into Iraq under U.S. discretion, which was more than $5 billion, flowed into the country in the final 6 weeks before the control of Iraqi funds was returned to the interim Iraqi government on June 28, 2004.

In the weeks before the transition, CPA officials ordered urgent disbursements. Fortunately, we have the record of the Federal Reserve, the New York Federal Reserve, of more than $4 billion in U.S. currency from the Federal Reserve, including one shipment of $2.4 billion, the largest shipment of cash in the bank's history.

As part of this report, Representative Waxman's staff reviewed thousands of pages of documents that were subpoenaed from the Federal Reserve Bank of New York, so we have a transparent system at the Federal Reserve in which we can account specifically for every dollar spent, and then it goes to Iraq and it basically disappears from the screen. No accountability. No paper trail. No way to follow the money.

These include a number of e-mails about this 11th hour spending spree, and I'd like to request the copies of these e-mails, some of which are quoted and cited in Representative Waxman's report, and I'd like to request that they be made part of the official hearing record.

For example, in the words of one Federal Reserve official who was writing on June 11, 2004, "Just when you think you have seen it all, the CPA is ordering $2,401,600,000 in currency shipped out on Friday, June 18th." While the Federal Reserve was preparing this shipment, the CPA pushed back the delivery date and requested an additional shipment. In a June 15, 2004, e-mail a CPA official wrote, "The new date is 22 June departure, with arrival, delivery on 23 June." This is also in the quote, "It is important that we make these dates as we have little flex time. Heads up." So this is a rush to get the money in place before the transition occurs. The quote goes on. "We are going to request a second mission for a 28 June delivery." That is an e-mail from Lieutenant Colonel Bill McQuail to Tina Smith June 15th quoting Colonel Don Davis. The emphasis is in the original, the heads up.

On June 16, 2004, a Federal Reserve official confirmed the delivery. "I checked the dates with Colonel Davis, and yes they want delivery to Baghdad on Monday the 28th."

I'd like to ask Mr. Norquist, can you explain?

Mr. SHAYS. For the record—I did not have my mic on—the gentleman has requested that we put in e-mails from the Federal Reserve into the record, and without objection, so ordered.

[The information referred to follows:]

Timothy Fogarty
06/11/2004 08:01 AM

To: Dino Kos/NY/FRS@FRS, Pauline Chen/NY/FRS@FRS, Valerie Rainford/NY/FRS@FRS, Carl Turnipseed/NY/FRS@FRS, Roseann Stichnoth/NY/FRS@FRS, Felicia Wiggin/NY/FRS@FRS, Robert Kraus/NY/FRS@FRS, Marybeth Butkus/BOARD/FRS@BOARD, Michael Silva/NY/FRS@FRS, Sophia Vicksman/NY/FRS@FRS, Annmarie RoweStraker/NY/FRS@FRS, Peter Roethel/NY/FRS@FRS
cc:
Subject: Upcoming currency shipment to Iraq

Just when you think you've seen it all.....the CPA is ordering $2,401,600,000 in currency to be shipped out on Friday June 18th.

----- Forwarded by Timothy Fogarty/NY/FRS on 06/11/2004 07:45 AM -----

"Davis, Don D. (O-6)" <davisdd@orha.centcom.mil>
06/11/2004 01:28 AM

To: <Timothy.Fogarty@ny.frb.org>
cc: <John.Kollar@ny.frb.org>
Subject: RE: FW: Account 021080782 frozen funds received from Lebanon

Got it. We will make it happen.

Thx,

Don

BTW---the plan is to depart DC on the 18th. The number requested is 2,401,600,000.00. In bricks of 100's this equates to 1,501.

Don

DON D. DAVIS, Col, USAF
CPA Comptroller
Room M107
DSN (318) 239-8955
Com'l (703) 343-8955
Cell (914) 822-9599

-----Original Message-----
From: Timothy.Fogarty@ny.frb.org [mailto:Timothy.Fogarty@ny.frb.org]
Sent: Friday, June 11, 2004 1:29 AM
To: Davis, Don D. (O-6)
Cc: John.Kollar@ny.frb.org
Subject: Re: FW: Account 021080782 frozen funds received from Lebanon

Timothy Fogarty@FRS
06/16/2004 08:57 AM

To: Marybeth Butkus/BOARD/FRS@BOARD, Robert Kraus/NY/FRS@FRS
cc:
Subject: New Mission Dates

I may have misunderstood the timing of the second shipment - if CPA wants this *delivered* to Baghdad on Mon 6/28, it has to get to Andrews on Sunday, right ? Our books are not open on Saturday or Sunday, and I doubt we would do that to accommodate this one transaction. If so, then we need to show the withdrawal from the DFI account on Fri 6/25 - but would we ship to Andrews on Fri, and USAF safe store it until Sunday ??? Or, would Cash (and Dunbar?) come in on Sunday and do this ?

----- Forwarded by Timothy Fogarty/NY/FRS on 06/16/2004 08:52 AM -----

"MCQUAIL, WILLIAM (LTC)" <WILLIAM.MCQUAIL @DFAS.MIL>
06/15/2004 05:07 PM

To: "Tina Smith (E-mail)" <smitht@sddc.army.mil>, "Maureen Rinehart (E-mail)" <RinehartM@MTMC.ARMY.MIL>
cc: "Don Davis (E-mail)" <davisdd@orha.centcom.mil>, <mike.mccormick@trmnet.com>, "Marybeth Butkus (E-mail)" <Marybeth.Butkus@frb.gov>, "Taylor, Charles A CPT ASA-FM" <Tony.Taylor1@hqda.army.mil>, "Tillotson, Jacqueline L. MAJ" <Jacqueline_L_Tillotson@belvoir.army.mil>, "Shane, Michael Mr CPA" <Michael.Shane@hqda.army.mil>, "Colon, Hector L COL ASA-FM" <Hector.Colon@hqda.army.mil>, "Combs, Judith R Ms ASA-FM" <judith.combs@us.army.mil>, <Timothy.Fogarty@ny.frb.org>, "Asberry, Herman III LTC ASA-FM" <herman.asberry@us.army.mil>, "Brian McLeod (E-mail)" <Brian.McLeod@Andrews.af.mil>, "Jeffrey Swasey (E-mail)" <jeffrey.swasey@Andrews.af.mil>, "Marcel O'Campo (E-mail)" <MARCEL.OCAMPO@Andrews.af.mil>
Subject: New Mission Dates

Ms. Smith, Ms. Rinehart,
I just spoke to LTC Asberry. He doesn't have email access currently, so asked me to contact you about the dates and two missions. COL Davis had earlier sent the following:

<?xml:namespace prefix = o ns = "urn:schemas-microsoft-com:office:office" /> "The new date is 22 June departure with arrival/delivery on 23 June. **It is important that we make these dates as we have little flex.**

HEADS UP! We are going to request a second mission for a 28 June delivery. We will firm this up before the end of the week.

Please let me know as soon as possible if you have concerns with these plans. "

I know the FRG has arranged for delivery to Andrews on 22 June for the first mission. Would you be able to support both missions on the required dates? I believe the second mission would require linking up at Andrews on June 27 to make the June 28 delivery. Thank you.

LTC Bill McQuail
Commander, U.S. Army Finance Command
DSN 699-3016
Comm. (317) 510-3016

-----Original Message-----
From: Asberry, Herman III LTC ASA-FM [mailto:herman.asberry@us.army.mil]

Robert Kraus
06/16/2004 03:43 PM

To: Timothy Fogarty/NY/FRS@FRS, Michael Silva/NY/FRS, Sophia Vicksman/NY/FRS, Pauline Chen/NY/FRS, Valerie Rainford/NY/FRS, Felicia Wiggin/NY/FRS, Richard Dzina/NY/FRS
cc:
Subject: Re: Proposed currency shipment for Iraq on SUNDAY 6/27...

From an operations standpoint a Sunday payout is not a problem we can certainly do that. The accountng is the issue.

Sent from my BlackBerry Handheld.
Timothy Fogarty

From: Timothy Fogarty
Sent: 06/16/2004 01:40 PM
To: Michael Silva; Sophia Vicksman; Pauline Chen; Valerie Rainford; Robert Kraus; Felicia Wiggin; Richard Dzina
Subject: Proposed currency shipment for Iraq on SUNDAY 6/27...

See below: I do not think FRBNY wants to open its books (IAS and FPS) on Sunday June 27 to effect a withdrawal of $1 bn in currency, nor necessarily bring in cash operations staff to prepare the shipment for pickup by the carrier. Here are some of the options I see are:

1 - we process the transaction on Friday and the carrier delivers to USAF on Friday, and USAF accepts/signs off on delivery and safe stores it Fri/Sat and puts it on the plane on Sunday, or

2 - we process the transaction on Friday and the carrier safe stores the shipment Fri/Sat (!!) and delivers to USAF on Sunday, or

3 - we process the accounting transaction on Friday but do not disburse the currency until Sunday (assuming that Cash staff can actually do that), or

4 - we process the transaction on Monday and CPA gets a later delivery.

If USAF balks at Option 1, then I think we will have to go with #4.....

Any other thoughts and/or creative ideas ?

----- Forwarded by Timothy Fogarty/NY/FRS on 06/16/2004 01:30 PM -----

Marybeth Butkus@BOARD
06/16/2004 09:01 AM

To: Timothy Fogarty/NY/FRS@FRS
cc: Robert Kraus/NY/FRS@FRS
Subject: Re: New Mission Dates

I checked the dates with Col Davis and yes, they want delivery to Baghdad on Monday, which would mean delivery to Andrews on Sunday.. we could check into the weekend storage but I am not sure Andrews would want to do that. They have stored over night before but this would be for 3 nights...

I mentioned to Col Davis that a Sunday delivery would be a little more difficult for us to pull off but if they need the funds on Monday, we will try and accommodate. I can check into the weekend storage to see what their reaction is.....

Mb
Timothy Fogarty@FRS

Timothy Fogarty
06/18/2004 11:58 AM

To: Felicia Wiggin/NY/FRS@FRS
cc: Michael Silva/NY/FRS@FRS, Pauline Chen/NY/FRS@FRS, Richard Dzina/NY/FRS@FRS, Robert Kraus/NY/FRS@FRS, Sophia Vicksman/NY/FRS@FRS, Roseann Stichnoth/NY/FRS@FRS, Annmarie RoweStraker/NY/FRS@FRS, Peter Roethel/NY/FRS@FRS
Subject: Latest on Iraq $

Bob, I just left you a voice mail - the CPA is now asking if INSTEAD OF doing the Sunday 6/27 shipment, we can ADD $1 bn to the already-scheduled Tuesday 6/22 shipment. If that is do-able, it avoids the whole Sunday accounting problem...but also makes it a ***$3 bn*** shipment...if the USAF agrees to do it, I would like to be able to give the CPA an answer today on our ability to put another $1 bn in $100's on the plane....

Felicia Wiggin

Felicia Wiggin
06/18/2004 09:48 AM

To: Timothy Fogarty/NY/FRS@FRS
cc: Joseph Marraccino/NY/FRS@FRS, Michael Falkowski/NY/FRS@FRS, Michael Silva/NY/FRS@FRS, Nirmal Manerikar/NY/FRS@FRS, Pauline Chen/NY/FRS@FRS, Richard Dzina/NY/FRS@FRS, Robert Kraus/NY/FRS@FRS, Robert Pofsky/NY/FRS@FRS, Sophia Vicksman/NY/FRS@FRS, Valerie Rainford/NY/FRS@FRS, Roseann Stichnoth/NY/FRS@FRS
Subject: Re: Proposed currency shipment for Iraq on SUNDAY 6/27...

Cash and Custody would need an internal Bank document authorizing the release of currency with a lag in the charge to the CPA.

Felicia Wiggin, Vice President
(201) 531-3235
felicia.wiggin@ny.frb.org
Timothy Fogarty

Timothy Fogarty
06/18/2004 08:04 AM

To: Robert Kraus/NY/FRS@FRS, Nirmal Manerikar/NY/FRS@FRS, Robert Pofsky/NY/FRS@FRS, Joseph Marraccino/NY/FRS@FRS, Michael Falkowski/NY/FRS@FRS
cc: Felicia Wiggin/NY/FRS@FRS, Michael Silva/NY/FRS@FRS, Pauline Chen/NY/FRS@FRS, Richard Dzina/NY/FRS@FRS, Sophia Vicksman/NY/FRS@FRS, Valerie Rainford/NY/FRS@FRS
Subject: Re: Proposed currency shipment for Iraq on SUNDAY 6/27...

It's my understanding that based on discussions Pauline had with Accounting, it is not outside the normal course of business for us to actually release currency from a FRB account on a Sunday, and effect the accounting entry on the next business day. Similarly, I just spoke with Mike Silva who pointed out that nothing in our agreement with the carrier relates to the actual internal timing of accounting entries, and they are on the hook for the shipment as soon as they sign for it, and so he is OK with this approach.

That said, it seems to me that contrary to our first assumptions, we *will* be able to deliver the $1 bn to the carrier on Sunday 6/28 for delivery to Andrews AFB for trans-shipment to Iraq, as originally requested by the CPA. I will advise the CPA today about this, so, if anyone has any last reservations, speak now or forever etc etc.....

Timothy Fogarty
06/21/2004 10:13 AM

To: Annmarie RoweStraker/NY/FRS@FRS, Peter Roethel/NY/FRS@FRS
cc: Pauline Chen/NY/FRS@FRS, Ann Rubin/NY/FRS@FRS, Anna Tikonoff/NY/FRS@FRS, Carol Huben/NY/FRS@FRS, Diane Coombs/NY/FRS@FRS, Janie Carter/NY/FRS@FRS, John Kollar/NY/FRS@FRS, Lois Walston/NY/FRS@FRS, Timothy Fogarty/NY/FRS@FRS, Wai Lei/NY/FRS@FRS, Michael Silva/NY/FRS@FRS, Sophia Vicksman/NY/FRS@FRS
Subject: Iraq Currency Shipments

Tues 6/22 as scheduled

Next shipment now will be on FRIDAY 6/25 for $1.4 bn

No other known shipments at this time (ie, no shipment for Sunday 6/27)...

---- Forwarded by Timothy Fogarty/NY/FRS on 06/21/2004 10:10 AM ----

Marybeth.Butkus@frb.gov
06/21/2004 07:18 AM

To: "Davis, Don D. (O-6)" <davisdd@orha.centcom.mil>
cc: "Asberry, Herman III LTC ASA-FM" <herman.asberry@us.army.mil>, Timothy.Fogarty@ny.frb.org, william.mcquail@dfas.mil
Subject: RE: Pocket Change

We can do a delivery to AFB on the 25th if Herman and Bill can arrange a flight that afternoon for delivery to you on the 26th...

Marybeth

"Davis, Don D. (O-6)" <davisdd@orha.centcom.mil>
06/20/2004 02:57 PM

To: "Asberry, Herman III LTC ASA-FM" <herman.asberry@us.army.mil>
cc: <Timothy.Fogarty@ny.frb.org>, <william.mcquail@dfas.mil>, <Marybeth.Butkus@Frb.GOV>
Subject: RE: Pocket Change

All,

We need to work the second mission as originally planned to arrive on 26th if at all possible. The 27th at latest. I am not sure we can get anything in here from the 28th through the 5 July. We have been ordered to limit travel out of the green zone between 28 June and 5 July. I am just hoping that we don't have to back this date up.

Michael Silva
06/28/2004 12:28 PM

To: larry.mcdonald@do.treas.gov, thomas.simpson@do.treas.gov, Thomas D Simpson/BOARD/FRS@BOARD
cc: tozerr@orha.centcom.mil, Pauline Chen/NY/FRS@FRS, Timothy Fogarty/NY/FRS@FRS, Ann Misback/BOARD/FRS@BOARD
Subject: Termination of CPA Authority

Larry & Tom:

I am afraid the sudden transfer of sovereign authority caught us completely unawares. One unfortunate complication of that is that our general Counsel, Tom Baxter, has taken a strong view that effective as of the time AMB Bremer transferred authority (which is being reported in the press as 10:26 am in Baghdad), the CPA no longer had control over Iraq's assets, including the CBI's assets on our books. This raises four issueswhich I feel I should alert you to so that you are not caught by surprise if they come up within the USG.

First, subsequent to transfer of sovereignty, COL Davis of the CPA sent us $200 million in payment orders to be executed today in New York. We have informed the Colonel that we are not in a position to honor those instructions.

Second, also subsequent to the transfer of sovereignty, COL Davis sent us an instruction to transfer $800 million from the DFI main account into the new DFI subaccount, which we understand informally was created by AMB Bremer to hold funds that are ear marked internally within Iraq for payments connected to existing contracts. We have also informed COL Davis that we are not in a position to honor this instruction either (especially since it would require liquidating $1 billion worth of the CBI's holdings of USG securities).

Third, in the letter AMB Bremer sent us transferring his authority over Iraq's assets to GOV Shabibi, he specified that the GOV's authority was not effective until July 1st. Since AMB Bremer's authority terminated when he lost his status under international law as an "occupying authority" and since GOV Shabibi's authority does not become effective until July 1st, we are looking at about a 72 hour period when the CBI's assets on our books will effectively be frozen.

Finally, and I don't mean to beat a dead horse here, I just want to remind everyone that effectively immediately we will not be in a position to divulge information to the USG concerning the CBI's assets on our books except pursuant to an instruction from GOV Shabibi. I keep brining this up b/c many parties have been getting different types of information concerning the CBI's account on our books and I don't want any surprised when that flow of information suddenly stops.

Please don't hesitate to contact me with any questions or comments.

Regards,
Mike

Michael F. Silva
Counsel & Vice President
Federal Reserve Bank of New York
Tel: (212) 720-8193
Fax: (212) 720-1530
michael.silva@ny.frb.org

Mr. SHAYS. The gentleman has time. We will give him an extra minute.

Mr. LYNCH. May I reclaim my time?

Mr. SHAYS. Yes, and you have more time, so the gentleman has about 3 minutes left.

Mr. LYNCH. Thank you, Mr. Chairman.

Mr. Norquist, if I can ask you, can you explain the reasons for these massive cash deliveries in the last days of the CPA? Earlier we heard that you trusted the ministries to spend their money without any accounting procedures. Why did not you trust them with this cash?

Mr. BENKERT. Let me try to break your question up here, Congressman, first. The DFI—and break up the management of the DFI into its component pieces——

Mr. SHAYS. Let me just interrupt to say the gentleman will have more time. You do not need to rush. So the gentleman will have more time to have you fully answer the question.

Mr. LYNCH. Thank you, Mr. Chairman.

Mr. BENKERT. I want to be clear on the management of the DFI at a fairly broad level. First of all, there were several pieces to this. This first was the export sale of oil and the deposits of proceeds from the sale of oil in some transfers from oil for food escrow accounts and so forth into the DFI. These were funds that were—so this was the deposit side of the ledger.

The International Advisory Monitoring Board in its oversight and based on audits from KPMG concluded that during the CPA's tenure all known proceeds from the sale of oil were properly deposited into the DFI and were properly and transparently accounted for in the DFI.

The second piece of this is disbursements from the DFI to other places. So, for example, the CPA—the administrator of the CPA was responsible for administration of the DFI. On the authority of the CPA administrator, disbursements were made from the DFI to Iraqi ministries—that is the $8.8 billion that Mr. Bowen testified about—or directly to projects of various sorts.

The International Advisory Monitoring Board concluded—again, based on KPMG audits—that during the period of the CPA's administration all disbursements from the DFI were properly authorized and recorded. All disbursements from the DFI were properly authorized and recorded.

The third piece of this then is once money had been disbursed from the DFI—remember, the DFI is a set of accounts held in the Federal Reserve Bank in New York and in the Central Bank of Iraq in Baghdad. Once money had been disbursed from the DFI to, for example, the Ministry of Finance and onto Iraqi ministries or to other projects, this is the piece that Mr. Bowen assessed in his audit, this piece of what happened to the money once it was disbursed from the DFI. And, as he found, there were weaknesses in this. But I would say, for example, of this $8.8 billion that went to the Iraqi ministries, there were observable results of what that money was spent on. Salaries for hundreds of thousands of government employees were paid. We know for a fact that the government workers were paid. Government ministries operated. We know that

they operated. Various projects were done on the behalf of those ministries, and we know what those projects are.

So there is a record of this, despite the fact that there were a number of internal control problems which both Mr. Bowen and KPMG identified in the management of these funds once they had been disbursed from the DFI, there were observable results.

Because those internal controls now would be residing with the Iraqi spending ministries and the Iraqi Ministry of Finance, those results have been provided to the Iraqi government, both by Mr. Bowen and by KPMG, so that the Iraqi government, again under the oversight of the IAMB, can ensure that internal controls are tightened up in the spending Ministry, and that process has been discussed between the IAMB and members of the Iraqi government.

Now, as far as the flow of cash into Iraq, I cannot speak to the pacing of the flow of cash into Iraq. I can only speak to these issues that I just mentioned about the accountability of these funds.

Mr. SHAYS. If the gentleman would yield a second—and he will have all the time he needs——

Mr. LYNCH. Thank you, Mr. Chairman. I yield.

Mr. SHAYS. Thank you. I just want to—I think the committee wants to be clear and, Mr. Bowen, you can make sure you are weighing in on this. Of the $8.8 billion in cash—and I understand they did not have an electronic system—is all $8.8 billion—this is where I am confused, frankly. Has all of that been signed by someone in the ministry, or is some of that in question? I mean, I know we have a question of how they spent it, but are we certain that all $8.8 got transferred to them? I'd like you, Mr. Benkert, first and then Mr. Bowen.

Mr. BENKERT. And I will defer to Mr. Bowen on some of the details of this, but I think what I have said is that the disbursement from the DFI was accounted for. In other words, from the—for funds that went to Iraqi ministries, the general flow was that funds would go to the Ministry of Finance, and then the Ministry of Finance would disburse the funds to the Iraqi ministries in accordance with their published budgets.

Mr. SHAYS. But this is not an electronic transfer. These are actually cash dollars——

Mr. BENKERT. That is correct.

Mr. SHAYS. And the question I am asking is: did the Iraqi ministry literally sign documents saying we got all $8.8? That is the question.

Mr. BENKERT. Right. And at that point, when the money passed from the Central Bank to the Ministry of Finance and on to the spending ministries, the disbursement from the DFI, that is, from the Federal Reserve Bank or from the Central Bank of Iraq to the Ministry of Finance, that disbursement was, according to the KPMG and according to the IAMB, those disbursements were properly authorized by someone, an appropriate person in the CPA, and properly recorded. The issue then is once it was disbursed from the DFI, from this account in the Central Bank or in the Federal Reserve Bank to the Ministry of Finance and on to the Iraqi ministries, the issue was the internal controls, the management con-

trols from that point onward, that is from the Ministry of Finance and on to the central and on to the spending ministries.

Mr. SHAYS. We understand. Mr. Bowen, do you agree with that?

Mr. BOWEN. Yes. Mr. Benkert has summarized it very well. The recording of disbursements from the CPA of the DFI that funded the Iraqi government is there. We have historical record of it. The issue is what happened to that money once it was distributed through the Ministry of Finance, the Iraqi Ministry of Finance, to the other ministries. That is the core issue with respect to the audit that we are here talking about, and that is managerial, financial, and contractual controls. They were weak. They were inefficient.

Mr. SHAYS. Or non-existent.

Mr. BOWEN. Or non-existent.

Mr. SHAYS. Let me just say——

Mr. BOWEN. Or they existed and were violated.

Mr. SHAYS. Let me just make sure we return this back to Mr. Lynch, but his main question, though, would anyone be able—this was his question. Why $2 billion-plus in the last week or so? Who can respond to Mr. Lynch's on that? And, Mr. Lynch, you just have the time again. Thank you for yielding.

Mr. LYNCH. Thank you.

Mr. BOWEN. I can address that. The $2 billion that we are talking about, we did do an audit of the DFI sub-account. There were—these funds went into a so-called DFI sub-account in the center district that funded continuing contracts. There was an agreement between the CPA and the Iraqi Ministry of Finance. That permitted the continuing funding of ongoing contracts.

Now, the concern that you raised and I was concerned about at the time is the pace of contracting in that last month. But our audit did not address that policy question. It addressed the management of those contracts under the DFI subaccount, and we had a number of findings specifically that—we are unable to track the exact amounts in the account, exact disbursements, and contract supporting documentation was inefficient.

Thank you.

Mr. LYNCH. Mr. Chairman, if I could, I just want to reclaim my——

Mr. SHAYS. You have the floor.

Mr. LYNCH. Thank you. Thank you, Mr. Chairman. I just want to go back. Mr. Benkert, I find the claim that we are properly informing IAMB of these expenditures and the flow of money to be preposterous when my last question we confirmed that IAMB was getting redacted copies, we were not giving them information. So I do not believe that at all, that there is some type of protection because IAMB is getting the information. They, indeed, were not, and I think we have shown that earlier.

Let me just respond, if I may. There is a big rush here last few days of the CPA before the conditional—the Coalition Provisional Authority expires. Big rush. Lot of dough changing hands here, huge amounts of cash coming out of New York into Baghdad.

Mr. Bowen, an audit that your office prepared found that the CPA staff—this is the Coalition Provisional Authority—were encouraged to spend cash quickly in the last days before the interim

Iraqi government took control of the funds. In the south-central region of Iraq, one disbursing official was given $6.75 million in cash on June 21, 2004 "with the expectation of disbursing the entire amount before the transfer of sovereignty on June 28, 2004."

It just appears to me that in these final days of the Authority before its expiration were looking for places to spend money. I just have to ask, do you gentlemen believe that all the cash expenditures, especially in these final weeks of the CPA's existence, were paid to existing contracts? It just puzzles me, if things were being spent properly through the ministries—and I understand your argument that the black hole occurs at the point of the ministry and not beforehand, but that is where the black hole occurs, but that does not really do anything for me. The money is being lost, whether what step we are losing it—you know, it may be interesting in a historical context in terms of who made the biggest mistakes. It was misspent. The fact that we allowed it to be misspent is, I think, our collective failure.

I just see this spending rush, if you look at the final transactions here that are made in these final days. There is a huge amount of money, the largest cash shipment in the history of the country, and it just begs the question why this transfer is occurring in the 11th hour. This is a perfect metaphor, I think, for what went wrong here. We gave people millions and millions and millions of dollars in DFI funds and told them to spend it in a week, and there was just no accountability.

Again, if anybody can tell me why all this money was spent in the fire sale manner in which it was spent, because it could have stayed in accounts. It could have stayed in accounts, gone over to the interim Iraqi government and spent for the proper purpose, if there was any accountability at all and if we had assurances that it was going to be spent on the proper purpose. Why the big—the massive, massive transfer of cash by the Federal Reserve Bank to the CPA in the final days with the direction to spend it as fast as you can because it is going to go over to the Iraqi interim government. I am not questioning whether it was properly authorized, Mr. Benkert. It was properly authorized. And it was—when the money was received it was properly accounted for when it was received. It is after that point that the black hole appears and we have no accountability at all and we have $20 billion out the door—not only the financial loss to the DFI and to the American taxpayer, but tragically a lost opportunity to help the Iraqi people in the way that was intended. That is the biggest lost opportunity here. We are still feeling that reverberation.

As patience grows thin with this whole operation in Iraq, this may be the biggest tragedy out of all of this, the fact that so much was spent here financially, in human lives of our men and women in uniform, and at the end, when we were going to execute our policy, the lack of accountability here robbed us of that opportunity.

If you have any response as to why this money was spent in this fashion without proper controls, I'd like to hear it. Thank you.

Thank you, Mr. Chairman.

Mr. SHAYS. I thank the gentleman. Anybody want to make a response?

Mr. BENKERT. If I could just make a brief response, I do not claim to have read Ambassador Bremer's mind about his decisions during this process, but I think there are some facts that bear on this. First of all, in the late spring of 2004 there were some substantial transfers, I think primarily from the U.N. oil for food escrow account, into the DFI, so there was an infusion of money in the spring which made possible, I think, in the CPA's view, which made possible addressing a number of needs that they had seen before but did not have funds in the DFI to address, one.

Two, obviously the CPA only had until the CPA went away if it wanted to take action on these things, because once the CPA ceased to exist and we transferred authority to a sovereign Iraqi government there was no control at all over the DFI and we had no way at that point of taking DFI funds and putting that against contracts, either existing contracts that we were administering or new contracts that we might want to put in place.

So I think these are the facts that bear on the matter, and I think the third point, I guess, that I would make is I think senior officials in this Department, at least, have always made clear that in the rebuilding of Iraq we would turn first to Iraqi resources rather than always relying on U.S. taxpayers' resources, and so these were clearly Iraqi resources that were available.

And then, finally, the CPA obviously had to be concerned about the fact that once this new Iraqi government was in place that it would be limited in what it could do because of the fact that it was an interim government and was not able to do the full range of things that might be needed in terms of some of this contracting.

So those are the facts. Again, I do not profess to speak here for Ambassador Bremer or his decisionmaking process. This is just what I know to be the case.

Mr. SHAYS. I thank the gentleman.

Let me say, in my line of questioning there is enough that is bad about this without our having to make it worse, frankly, but there are some things that I'm comfortable with and there are some things I'm not comfortable with.

In my visits, I remember meeting with the shadow ministries. They had a play in how money was spent. Budgets were made as to where things should go. But ultimately Mr. Bremer had the final decision. There were some ministries that were not getting enough. There were some that were getting enough. There were some of Mr. Bremer's folks who were out in the field who were not getting enough—enough people, enough resources—and there were some that may have been. There were some in the military that wanted to spend money in ways—Mr. Patrias, frankly, did an awesome job—General Patrias, excuse me—did an awesome job of getting money out right away and, in my judgment, helping deal with some potentially very difficult programs early on.

I have problems with the disbanding of the army, the military, and the police. My gosh, if we just kept the army in place and left them on base it would have been better than what we did. So we all have our things that we think went well and did not go well.

It is a fact, I believe, that about $12 billion of cash was sent over, about $8.8 was given to the ministries, but there is other cash that was given directly to contractors; is that correct, Mr. Bowen?

Mr. BOWEN. That is correct.

Mr. SHAYS. And so when I see a picture like this I get a little unsettled because it looks a little bit like the picture that Mr. Kucinich put up. You like to feel that if there is $2 billion worth of money, that guys are not having a picture taken of holding $2 billion. It looks a little loose to me.

Mr. BOWEN. I share your concern.

Mr. SHAYS. Yes. So that is the bad part of this story. It is very clear that when it comes to the cash part we did not have systems in place to account for them. It does not mean they were not spent well, but, given my sense of human temptations, I suspect some of it was, frankly, taken. The extent of that is—I cannot believe that all this cash just floating around all went perfectly to the right place. And I think it makes sense for us to try to determine how much did not go in the right places.

I also know that Mr. Bremer had a 20-hour work day and he made good decisions and he made bad decisions. He probably would have made better decisions if he was willing to have other people share in some of these decisions. He, in my judgment, was a pretty strong micro manager and he chose, in a sense—the irony is, as I looked at it, it was almost like Baghdad being recreated. I mean, all that power was so centrally located.

I was, frankly, very happy when the power was transferred in June of that year. If money was going to be wasted, I'd rather have the Iraqis who waste it and not the Americans, and I'd like them to begin to start—I do not want any of it wasted, but I would rather have them start to have a say in this process.

I want to be clear about this. It seems to me that the testimony is that, for instance, with Kellogg, Brown and Root and others there are what they proposed as costs, there is what we called questioned by DCAA, correct, and there is some that is unsupported. I suspect that some of the unsupported will be supported and payments will be made, and I suspect that some of the questioned, some of it will not be paid and some of it will.

Mr. Reed, is that correct?

Mr. REED. That is correct.

Mr. SHAYS. OK. So that is a work in process. We will have a more definitive response to that in the days and weeks to come; is that correct? I mean, you will nail down that as it relates to this contractor and others, as well?

Mr. REED. That is correct. It is important to note that this is part of the administration of the contract. This is not a matter of coming in and saying, "OK, we messed up, and who screwed up and how much?" This is just the way the contract is being administered. There is oversight throughout the process and the contracting officer is using his auditors to determine if the contractor is complying with the terms of the contract and these costs should be paid or not paid, and we are in that process.

Mr. SHAYS. And the reason is this is what we call cost-plus, and so you may dispute what they call a legitimate cost. You may not feel it is a legitimate cost. Or you may find that they spent money in areas where they were not authorized to spend money; is that correct?

Mr. REED. That is correct. In this process in many cases there is not an absolute right or wrong in terms of compliance. There are grays, like what is a reasonable cost. That is what the auditor's job is, to bring before the contracting officer whatever facts exist and whatever other information might be useful to the contracting officer to make a fair settlement and negotiate of that.

Mr. SHAYS. Is this a negotiated process?

Mr. REED. Yes, it is.

Mr. SHAYS. But let me ask you, in the end do you, Mr. Reed, you pass your opinion on to Colonel DuBose, and, Colonel, you are the ultimate decisionmaker on whether or not a payment is made?

Colonel DUBOSE. It is actually the contracting officer who uses the information from DCAA on——

Mr. SHAYS. I'm not picking you up for some reason. Is your light on?

Colonel DUBOSE. It is on now, sir.

Mr. SHAYS. OK. Given that I did it wrong three times in a row——

Colonel DUBOSE. Sir, the contracting officer—I'm not the personal contracting officer. We have many contracting officers.

Mr. SHAYS. But are the contracting officers within your——

Colonel DUBOSE. Absolutely, sir.

Mr. SHAYS. So they are under your command?

Colonel DUBOSE. So they take the information from the DCAA audits, they get information from our field reps who observe the contractors' performance. We rate their performance. And all of that goes into the negotiations on the final payment and is considered in determining the award fee. Because this is a cost-plus, the profit is determined on how well they performed, and these measures are taken into account before we give any profit.

Mr. SHAYS. Well, it concerns me you say negotiate. I mean, I'm happy it is negotiated, but in the end does someone get to make the decision or——

Colonel DUBOSE. Yes, sir, the contracting officer.

Mr. REED. The contracting officer makes the final decision as to the allowability of the cost.

Mr. SHAYS. And, Mr. Reed, is your mic on?

Mr. REED. Yes, it is on.

Mr. SHAYS. Mr. Reed, but you make the recommendation to the contracting officer? You do not decide, correct?

Mr. REED. That is correct.

Mr. SHAYS. OK. And, Colonel, it is under your department, your agency, your ultimately—but you defer to the contractor because they know, you do not?

Colonel DUBOSE. No, sir.

Mr. SHAYS. Contracting officer?

Colonel DUBOSE. The contracting officer takes the information from the people who observe the contractor's performance, from the auditors who——

Mr. SHAYS. These are your people, correct?

Colonel DUBOSE. Yes, sir.

Mr. SHAYS. Just so I am very clear, they ultimately make the decision?

Colonel DUBOSE. Yes, sir.

Mr. SHAYS. OK. And they are empowered to make the decision? You cannot overrule them even——

Colonel DUBOSE. Yes, sir.

Mr. SHAYS. OK.

Colonel DUBOSE. Absolutely.

Mr. SHAYS. All right. Let me, just for the record—is there anything—and you may say something that triggers a comment from any of the Members who are here, and they are free to a make a comment, but is there anything that you feel we need to put on the record to make this record more complete before we go to the next panel? Mr. Benkert.

Mr. BENKERT. If I could just clarify one thing, this is relating to the various questions about what has been provided to the IAMB and our transparency with the IAMB. I just want to be clear and point out that under the IAMB's oversight KPMG, an internationally recognized accounting firm, has conducted three very extensive audits of all aspects of the DFI since its inception. Two of those audits covered the period from its inception until the CPA went away, one of the audits covered the period from June 28th or 29th until the end of last year. These audits—again, these are KPMG audits. They are very extensive audits. They cover—they are publicly available audits that the IAMB posts on its Web site. They cover the financial statements of the DFI, they cover internal controls of the DFI, they involve audits both of the financial side but also visits by the auditors to individual ministries of the Iraqi government to be able to verify the controls in place, and they include findings on financial controls, managerial controls, contract controls. So that very extensive information is what goes to the IAMB.

The only issue—and I think the issue you have raised here today—has to do with a very one specific set of contracts, the KBR restore Iraqi oil contracts, and a set of audits that relate specifically to that contract, but in general there is a very extensive set of audits done by KPMG on the DFI as a whole that have no redactions, are publicly available, posted on their Web site, and that go to the IAMB, and those are the audits on which the IAMB bases its judgments of the management of the DFI, including the judgments that I referred to earlier.

Mr. SHAYS. Just to state this again, though, and I cannot state it strongly enough. It seems to me like we have treated the U.N. request as a FOIA request, and they are partners in this. They are not some individual citizen requesting this information. They basically empowered us to run a program they were in charge of. And so it seems to me, you know, sometimes lawyers can keep you out of jail but they make you look guilty as hell in the process, and it seems to me the lawyers got carried away here. They make it look like we're trying to hide something from the world community as we are asking the world community to cooperate with us about oil for food. It really ticks me off because it just seems senseless. Frankly, I do not think this information is that big a deal either way. So it is just a view I hold.

Anyone else want to make a comment here before we get to the other panel?

Mrs. MALONEY. I would if I could, Mr. Chairman.

Mr. SHAYS. Sure.

Mrs. MALONEY. You know, we have our own auditor there, IG who gave us very troubling information.

Mr. SHAYS. Own auditor where? I'm so really?

Mrs. MALONEY. Mr. Bowen, auditor for the U.S. Government. Why in the world are we referring to KPMG when we know that certain information was withheld from them, particular in the Halliburton case. That was well documented. And KPMG can say that everything is wonderful and honkey-dory and roses, but the Government auditor, Mr. Bowen, pointed out tremendous problems in the commander's fund, $7 million that evaporated into thin air. He has no idea where it is. And questions of $80 million more with no documentation. And he's only looking at one region. He does not have the resources to go into the other regions and no one is looking at it. So I think to be citing an auditor employed by a different organization that does not have access to the information that the auditor from the U.S. Government has—and he pointed out extremely troubling things in the commander's funds and in Mr. Bremer's organization, $8.8 billion missing. These are serious items that he put forward, and I think his testimony—my main point is why are we citing all these other auditors who are saying everything is wonderful when we have our own Government auditor who is saying things are in a big mess, to say the least, and that millions and zillions of dollars are missing.

Mr. SHAYS. I would just—I want to make sure I do not disagree with part of what the gentlelady said. We have an issue of what happened to $12 billion of cash, of which $8.8 was given to the ministries. We can document they were given to the ministries. The question is what did the ministries do with it. And we can be pretty certain, based on—with no disrespect to Iraqis—some of it was spent well and some of it was not, and some of it was siphoned off by the Iraqi government.

The other issue is what's the balance of that. When you take the $8.8 billion, what is the balance that went to contractors? What I was referring to was the issues of the redacted information as it related to Kellogg, Brown and Root, which is something different than the cash payment issue. It is an issue of what is in dispute, how do we characterize what is in dispute, and will we ultimately know what the disagreement is.

It is not unlike someone putting in a request for their health bill to be paid for and some of—the insurance company says, "We will pay for this, but we will not pay for that," and they have a dispute. We do not say that what is not paid that the individual tried to cheat the government, we just acknowledge that there is a dispute and then we can judge that dispute one way or the other. It is not to say that some of that money may have been just an outrageous request, thank God DCAA saw it and put a stop to it. That says the process is working, that they caught it and it is being resolved. That part I do not fault our Government for at all. That is just my take on this. But I do not dispute about the concern about cash.

Mr. Kucinich, and then it would be good to get on to the other panel.

Mr. KUCINICH. Mr. Chairman, thank you. I will be brief here.

One of the things that I find very disturbing about Mr. Benkert's recitations is that nowhere do we hear any kind of an assertion

about the responsibility of the Coalition Provisional Authority or any U.S. Government oversight once the money passed through to the Iraqi ministry. It seems to me that what's happening here—and I hope that I am not correct in this assumption—is that there is an attempt here to basically whitewash this $8.8 billion that is not accounted for by saying, well, the Iraqis are handling it now. Frankly, Mr. Benkert, I do not think there is enough whitewash in the whole world to cover over $8.8 billion that cannot be accounted for.

So I am just respectfully suggesting, Mr. Chairman, that this committee—that we be very careful about assuming that this is simply the responsibility of the Iraqi ministry and not somehow the responsibility of the Coalition Provisional Authority which had custody of the money before it went to the Iraqi ministry. I mean, Mr. Bowen, there must be some kind of a chain of custody with respect to the money and some type of oversight responsibility of the Coalition Provisional Authority for the funds that were given to the Development Fund for Iraq.

Mr. SHAYS. Let me just explain my take on it. Correct me if I am wrong. When we transfer power in June of last year, we took DOD and Mr. Bremer out of running the country. We gave it to the Iraqi people. It was a stunning moment in time. We ended up transferring the responsibility and our communication with the government from DOD to State Department, and that was stunning. We became advisory rather than controlling. I can illustrate it when I was there at a press conference in August of that last year. I met with the new Prime Minister. I met with the Foreign Minister and the new Ambassador Negroponte and I walked out with the Foreign Minister. I held a press conference in August of last year and I was excited about this press conference and I thought, well, here we go, and I explained I had been there a number of times and that we had made some mistakes and done some things well, but now there is a new Iraqi government.

The first question was to the Foreign Minister, not to me or Negroponte. The second question was to the Foreign Minister, not to me or Negroponte. The third question was to the Foreign Minister, not to me or Negroponte. The fourth question. Finally I asked if there were any more questions. There were not. I said to Mr. Negroponte, "What better proof that we have transferred power."

The bottom line was that $8.8 billion was their money. We had given it to them. It was their country. They were in charge of it. It was their right to spend it well or to screw it up. The one thing we were certain of was that we gave it to them. It is not an issue of whether it ever reached them. And that is the bottom line to it as it related to those dollars.

I understand how you would have liked it spent better and I would have, but once we gave them the ability to run their own country, they can spend their money as they choose. It was not the money that we appropriated from here.

Mr. KUCINICH. Would the gentleman yield for a simple question?

Mr. SHAYS. Sure.

Mr. KUCINICH. Here's the concern. Them. They were our people. We put them in charge. These were people that we installed, basically. So if we installed them, there was a relationship between the

Coalition Provisional Authority and these individuals, and so that is where these questions I think are relevant.

I again want to applaud the Chair for the manner in which he has conducted this in allowing all these questions to come forward. Thank you, Mr. Chairman.

Mr. SHAYS. Thank you, and I thank you for the question.

Mrs. Maloney, you have questions and you have the right to ask your questions, so feel free, and then we will get on to the next panel.

Mrs. MALONEY. Thank you, Mr. Chairman, very, very much. I thank all of the panelists. I want to return to the redactions that took place on the Halliburton overcharges, which were tremendously disturbing to me that the Defense Department basically hid Halliburton's overcharges and, in my opinion, did it with a rationale that is totally not defensible.

I want to talk about this, because I really feel that working on the Freedom of Information Act that the oversight of Government is very important. That is why I joined this committee. I would like to really take a closer look at the Department's rationale for allowing Halliburton to delete all mentions of overcharges in Pentagon audits.

Mr. Tyler, you are here right, Mr. Tyler, and I'd really like to ask you how could overcharges identified by Government auditors be considered confidential business information. These are findings and work of Government employees.

Mr. SHAYS. If the gentleman would maybe sit at the corner—do you have a card that you could give our transcriber? We will make sure that is given to her.

I do want to say that there is another hearing in this room and we are going to have votes, so I need to move us along.

Mr. TYLER. I will try to make this very quick.

Mr. SHAYS. Please identify yourself.

Mr. TYLER. My name is Joe Tyler. I work with U.S. Army Corps of Engineers. My position is the chief of the program integration division in military programs.

Let me try to clarify two points. The law that we were concerned about concerning the audits is the Trade Secrets Act. That is 18 U.S.C. 1905. I'm not a lawyer, but I can quote the right law. It is very broad. It covers any Government employee that is—I'm going to kind of quote from it—any Government employee of the United States that publishes, divulges, discloses, or makes known in any manner or to any extent not authorized by law any information coming to him in the course of his employment or official duties or by any reason of any examination or investigation made by that person. It covers information that concerns or relates to trade secrets, processes, operations, style of work or apparatus, or to the identity, confidential statistical data, amount, or source of any income, profits, losses, or expenditures of any person, firm, partnership, or corporation. It is very broad.

Mrs. MALONEY. OK.

Mr. TYLER. When we look at audits and we talk about giving them to the public, our concern goes to what is allowed under the Trade Secrets Act. Giving it to Congress, that is not the public so there is no problem.

Now, when we made the determination on this particular point we were giving it to the IAMB, which works under the United Nations, which is not part of the U.S. Government. I cannot address their authority under our laws versus the Trade Secret Act. I'm not—I do not understand that.

Mrs. MALONEY. Mr. Tyler.

Mr. TYLER. Could I go on just a second? But the authority to allow us to release this fell under the purview of the Trade Secrets Act. The Corps of Engineers originally was asked by OSD to release the audits unredacted, just clear. We said under the Trade Secrets Act we had some concerns. We went to KBR, as we stated. KBR said no, we do not agree releasing them under the Trade Secrets Act, and they said—we then went back and said we could not release them. OSD said, "Can you find a way Corps of Engineers to be as transparent and release as much as we could." We then went to KBR. They then said yes, we will agree to release them if we're allowed to redact the items that we feel fall under the purview of the Trade Secrets Act. We then asked them to do that, and that is the documentation that we ultimately provided to the IAMB.

I hope that answered your question.

Mrs. MALONEY. Mr. Tyler, if I could respond, at a prior subcommittee meeting and hearing William Leonard, the director of the Information Security Oversight Office of the National Archives testified that he had "never encountered a case in which the Government has withheld as proprietary business information the actual amount a company overcharged the Government." Also testifying before this committee Harold Relyea of the Nonpartisan Congressional Research Service testified, it is hardly proprietary information. So Henry Waxman and I went to the private sector to look into their expertise on the Trade Secret Act and the Freedom of Information Act, and I have three documents that I ask permission to place into the record.

First is Thomas Sussman, an attorney and regulatory expert, who told us, "I cannot conceive of a fact situation where overcharges would qualify as trade secrets or confidential commercial information."

Professor James O'Reilly, who wrote a document of Federal information disclosure said, "Audit documents and findings are created by the agency and are not subject to proprietary claims as a private company's recipe, formula, or other classified trade secret."

And Professor Henry Parrot, the former dean of Chicago Kent College of Law, told us, "Government auditors' statements are not trade secrets."

So overcharges to the Government are not trade secrets, according to the private sector and the public sector, and I request to place these documents in the record.

Mr. SHAYS. Without objection we will do that.

[The information referred to follows:]

Henry H. Perritt, Jr.

Professor of Law and
Director, LL.M. in Financial Services Law

Telephone: 312-906-5128
hperritt@kentlaw.edu

June 20, 2005

The Honorable Henry A. Waxman
Ranking Minority Member
Congress of the United States
House of Representatives
Committee on Government Reform
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Congressman Waxman:

I am responding to your letter of 17 June 2005, in which you requested my assistance in answering a number of questions pertaining to the issue of whether the Freedom of Information Act ("FOIA") or the Trade Secrets Act prohibits the Defense Department from disclosing to the pubic contractor overcharges identified by Pentagon auditors in completed audit reports.

I am a Professor of Law and former Dean of Chicago-Kent College of Law, the law school of Illinois Institute of Technology. I have been a full-time law professor for 24 years, and have written extensively on administrative law and intellectual property law, including a book entitled "Trade Secrets for the Practitioner," published by the Practising Law Institute, and several articles on the Freedom of Information Act. I have taught administrative law for many years, and served as a consultant to the Administrative Conference of the United States.

Before addressing your specific questions, I am providing some basic information on protection of trade secrets under FOIA and the Trade Secrets Act. I have limited my analysis to disclosure of information alleged to be trade secrets or confidential commercial or financial information. I have not considered possible applicability of other FOIA exemptions such as those pertaining to national security. I have also not undertaken a review of the Federal Acquisition Regulations ("FAR") to identify pertinent disclosure provisions. If you would like me to consider those areas of law please inform me.

The Freedom of Information Act, 5 U.S.C. § 552, imposes an obligation on federal agencies to make "records" available to the public upon request. No reason need be given by a requestor, and the statute is construed to favor disclosure. The Act provides, in Subsection (b), nine categories of records that are exempt from disclosure under Subsection (a). Exemption 4, 5

U.S.C. § 552(b)(4), exempts "trade secrets and commercial or financial information obtained from a person and privileged or confidential."

There is strong presumption in favor of full disclosure of records subject to the Freedom of Information Act (FOIA), and the government bears the burden of establishing that one or more of the FOIA exemptions applies when it seeks to withhold requested information. Department of State v. Ray, 502 U.S. 164, 173 (1991) (stating principle, and finding that personal-privacy and personnel-records exemptions applied to records regarding Haitaiin refugees); Washington Post Co. v. U.S. Dept. of Agriculture, 943 F.Supp. 31 (D.D.C.1996) (granting newspaper's motion for summary judgment compelling release of names of recipients of public assistance; not within privacy exemption).

Exemption 4 of the Freedom of Information Act covers two types of information: trade secrets, and other commercial information that is either privileged or confidential. The subsection has been interpreted as covering trade secrets as they are defined by state law, although one D.C. Circuit case suggests a narrow construction of the trade-secrets exemption.

In Public Citizen Health Research Group v. Food & Drug Administration, 704 F.2d 1280 (D.C. Cir. 1983), the court of appeals reversed a determination that data relating to the safety and efficacy of intraocular lenses was exempt from disclosure under Exemption 4. The court of appeals, in an opinion authored by Judge Edwards for a panel including Judge (now Supreme Court Justice) Scalia, concluded that the district court had used an overly broad definition of trade secrets under Exemption 4, because it had used the definition contained in Section 757 of the *Restatement of Torts*. The court acknowledged that the *Restatement*'s broad definition has been accepted in a variety of private law contexts, but questioned whether Congress meant for it to govern FOIA cases. The court repudiated "the broad *Restatement* approach" and defined trade secrets "in its narrower common law sense, which incorporates a direct relationship between the information at issue and the productive process." Id. at 1288

The court justified its choice of the narrower definition based on the difference between the FOIA's goals and the private law goals of trade secret law, which focus on defendant wrongdoing, unjust enrichment, and competitive.

Exemption 4 permits protecting non-trade-secret data when it qualifies under the other prong, covering commercial and financial information. Commercial or financial information "is confidential and therefore within the scope of Exemption 4 if it is required to be submitted to the Government and if its disclosure is likely to cause substantial harm to the competitive position of the person from whom the information was obtained." McDonnell Douglas Corp. v. U.S. Department of the Air Force, 375 F.3d 1182, 1187 (D.C. Cir. 2004) [internal quotations and citations omitted].

The "Trade Secrets Act," 18 U.S.C. §1905, by its literal terms only imposes criminal penalties on federal employees who divulge trade secrets and similar information, unless authorized by law. Release of information covered by FOIA and not within Exemption 4 is authorized by law and thus outside the scope of the Trade Secrets Act. Chrysler Corp. v. Brown, 441 U.S. 281, 292 (1979). Private parties may not sue to enforce the Trade Secrets Act directly,

but they may seek an injunction against disclosure of information covered by Exemption 4 and the Trade Secrets Act under the Administrative Procedure Act because such disclosure would be in violation of law. McDonnell Douglas Corp. v. U.S. Department of the Air Force, 375 F.3d 1182, 1186 & n.1 (D.C. Cir. 2004).

For example, in *Bartholdi Cable Co. v. FCC*, 114 F.3d 274 (D.C. Cir. 1997), the D.C. Circuit held that the FCC did not act arbitrarily and capriciously in determining that the public interest required disclosure of alleged trade secrets in conjunction with a case involving unauthorized microwave transmissions. While, the court held that release of information covered by Exemption 4 ordinarily is prohibited indirectly by the Trade Secrets Act, it suggested that an agency might nevertheless have the power to release such information when it determines reasonably that the public interest militates in favor of disclosure. 114 F.3d at 282.

In *Qwest Communications International, Inc. v. FCC*, 229 F.3d 1172 (D.C. Cir. 2000), the D.C. Circuit held that the Communications Act of 1934 authorizes the FCC to release trade secret information, obtained for purposes of an audit, but that the commission had failed to explain the need to do so in the particular case, given its longstanding policy of protecting trade secret information.

Now, as to your specific questions:

1. Under FOIA and the Trade Secrets Acts, who has ultimate responsibility for deciding whether auditor findings in government audits may be disclosed—the government or the contractor?

The government has the responsibility for applying FOIA to requested information. It must consider, however, submissions by the contractor arguing that the information qualifies for Exemption 4. Ultimately, a federal district court may review the government's decision to see whether it is arbitrary and capricious under the Administrative Procedure Act.

2. Under FOIA and the Trade Secrets Act, is a contractor entitled to prohibit the disclosure of all information contained in a government audit, including information that is not proprietary?

The contractor is not entitled to "prohibit" anything. It is up to the agency possessing the information to determine its obligations to disclose under FOIA. Information that is not proprietary would not qualify either as a trade secret or as confidential commercial information under Exemption 4 and thus the agency would be prohibited by law from withholding it from a requesting member of the public.

3. Under FOIA and the Trade Secrets Act, are the amounts of contractor overcharges (questioned costs and unsupported costs) identified by government auditors in completed audit reports "proprietary information" or a "trade secret" belonging to the contractor?

It depends. Government auditor statements themselves do not qualify under Exemption 4 because they are not trade secrets, in that they can confer no competitive advantage; and they are

not commercial information. If the overcharges involve detailed costing information submitted by the contractor that confer a competitive advantage on the contractor because they are not generally known, they might qualify for Exemption 4, but the burden is on the contractor to establish that.

4. Under FOIA and the Trade Secrets Act, is a contractor entitled to redact information in government audits that it merely disagrees with, believes is misleading, or may find embarrassing?

A contractor is not entitled to redact anything. The auditing agency may redact information that qualifies for Exemption 4 (or any other FOIA exemption). As pointed out in the answer to Question 3, information originating with the government cannot qualify for Exemption 4, only information originating with the contractor. That contractor information might prove "misleading" or "embarrassing" does not qualify it for Exemption 4, or any other FOIA exemption.

5. Are you aware of any instances in which contractor overcharges identified by government auditors have been legitimately concealed from the public under FOIA or the Trade Secrets Act?

No, with respect to audit reports of contractor overcharges, but there are a few reported cases involving other types of information obtained through audits. In *Burke Energy Corp. v. Department of Energy*, 583 F. Supp. 507 (D. Kan. 1984), the district court denied an injunction compelling DOE to release the results of an audit of an oil company pursuant to a FOIA request. The district court found that the withheld information qualified as confidential commercial information within Exemption 4.

In *State v. Department of Energy*, Dkt. No. Civil 4-81-434, 1982 WL 1155 (D. Minn. Dec. 14, 1982), the district court, in an unreported opinion, reached a similar conclusion with respect to information obtained through an audit. In *United States ex rel. Brown v. Merant, Inc.*, No. CIV. A. 99-6481, 2002 WL 487160 (E.D. Pa. Mar. 29, 2002), a qui tam case, the district court noted that the GSA had disclosed, pursuant to a FOIA request the results of an audit which identified overcharges by a government contractor. In *Christmann & Welborn v. Department of Energy*, 589 F. Supp. 584 (N.D. Tex. 1984), affirmed an agency decision to release some audit-file information pursuant to a FOIA request and to withhold other information, already found to be privileged from civil discovery.

I hope this information is responsive to your needs.

Sincerely,

Henry H. Perritt, Jr.
Professor of Law

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Fax (513) 556-1236

June 20, 2005

Mr. Andrew Su
Professional Staff
House Comm. On Government Reform
Via fax 202 226-3348

Dear Mr. Su:

Enclosed please find responses to your questions.

Thanks for the opportunity to comment.

Cordially,

Prof. James T. O'Reilly

An affirmative action/equal opportunity institution

RESPONSES TO QUESTIONS RE OVERSIGHT OF PUBLIC CONTRACT AUDIT REPORTS

PROF. JAMES T. O'REILLY
UNIVERSITY OF CINCINNATI

1. Under FOIA and the Trade Secrets Act, who has ultimate responsibility for deciding whether auditor findings in government audits may be disclosed -- the government or the contractor?

The government.

2. Under FOIA and the Trade Secrets Act, is a contractor entitled to prohibit the disclosure of all information contained in a government audit, including information that is not proprietary?

No.

3. Under FOIA and the Trade Secrets Act, are the amounts of contractor overcharges (questions costs and unsupported costs) identified by government auditors in completed audit reports "proprietary information" or a "trade secret" belonging to the contractor?

No.

4. Under FOIA and the Trade Secrets Act, is a contractor entitled to redact information in government audits that it merely disagrees with, believes is misleading, or may find embarrassing?

No.

5. Are you aware of any instances in which contractor overcharges identified by government auditors have been legitimately concealed from the public under FOIA or the Trade Secrets Act?

No.

DISCUSSION

The 1906, 1933 and 1948 versions of the Trade Secret Act, 18 U.S.C. 1905, and its clarifications in the U.S. Attorneys Manual, unquestionably establish that the law is

intended to criminally punish a knowing and unauthorized action of an individual federal employee. The Act is not a constraint on the institutional decisions of the federal agency. If an institutional constraint is to be placed on the agency decision regarding confidentiality, as Congress has done in more than a hundred specific statutes that conform to Freedom of Information Act (FOIA) exemption 3, 5 U.S.C. 552(b)(3), then the Congress is free to do so. To the best of my knowledge and research it has not done so in this context.

An institutional decision to withhold records under FOIA is permissive, not mandatory, see the terms of 5 U.S.C. 552(b); the FOIA exemptions cannot be invoked against the Congress, see 5 U.S.C. 552(d).

When the Supreme Court addressed the intersection of the FOIA with the Trade Secrets Act in Chrysler Corp. v Brown, 441 U.S. 281 (1979) it drew the distinction that is most relevant here: is the agency constrained by some particular specific statute or rule from making the disclosure? To the best of my knowledge and research the federal auditing agencies have not been so constrained.

As to the audit document and findings, they are created by the agency and are not subject to proprietary claims as a private company's recipe, formula or other classical trade secret would be potentially subject.

Redaction of disagreed findings, opinions or embarrassing information is not within the scope of 18 U.S.C. 1905 and there is no predicate for considering it confidential commercial data under FOIA for purposes of the applicable case law standard, the D.C. Circuit's canon of interpretation in National Parks & Conservation Assn. v Morton, 498 F.2d 765, 770 (D.C. Cir. 1974). [The alternate standard for evaluating purely voluntary submissions is not applicable to federal contractors' mandatory provision of audit records.]

Thank you for the opportunity for comment. These reflect my own views and not necessarily those of the University. My treatise, Federal Information Disclosure (3d Ed. West, 2005 Supp.) is the national standard reference work since 1977 and its relevant portions are in Volume 1, chapters 10 and 14.

James T. O'Reilly

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June 20, 2005

Thomas M. Susman
(202) 508-4620
thomas.susman@ropesgray.com

Honorable Henry A. Waxman
Ranking Minority Member
Committee on Government Reform
Washington, DC 20515

Re: Questions Posed by Your Letter of June 17, 2005

Dear Congressman Waxman:

I received your letter requesting my opinion on questions relating to application of the Freedom of Information Act and the Trade Secrets Act to disclosure of public contractor overcharges identified by Pentagon auditors in completed audit reports.

As you know, I have been involved with the Freedom of Information Act (FOIA) since 1968 as a Justice Department lawyer, Senate committee counsel, and counsel to commercial clients, associations, and public interest organizations. I have litigated FOIA cases, been involved in both obtaining and protecting from disclosure information held by a variety of government agencies, testified before Congress on FOIA oversight and legislation, taught classes and courses on government information law and policy, and consulted with foreign governments on open government information regulation. I have written articles on FOIA and co-authored BNA's Portfolio on "Business Uses of the Freedom of Information Act." I am pleased to respond to your questions based upon this experience; my views are personal and do not represent those of any client.

1. Under FOIA and the Trade Secrets Act, who has ultimate responsibility for deciding whether auditor findings in government audits may be disclosed – the government or the contractor?

The FOIA clearly applies by its literal terms to agencies of the federal government. Agency personnel have the responsibility to make determinations regarding disclosure or withholding under the Act and, in addition, whether "any reasonably segregable portion of a record" must be provided as required by that statute. While the agency may request guidance from the submitter of a record regarding whether information should be withheld, the legal responsibility to decide whether to disclose or withhold is on the agency and cannot be delegated to a government contractor.

2. Under FOIA and the Trade Secrets Act, is a contractor entitled to prohibit the disclosure of all information contained in a government audit, including information that is not proprietary?

As I stated in answer to Question 1, the agency may obtain guidance from the contractor regarding any claim that information constitutes trade secrets or confidential business information that may be withheld under FOIA and must be withheld under the Trade Secrets Act (TSA). In fact, where information has been provided by the contractor, Executive Order 12,600 requires the agency to establish procedures for providing submitters notice and an opportunity to comment on potential disclosure of confidential commercial information. The contractor's views are, under the Executive Order and agency rules, strictly advisory. The agency, not the contractor, must make the final decision on disclosure, since the audit report in issue is a government record. While the agency should ordinarily respect the contractor's designation of information as confidential commercial information, the contractor has no right – and should have no ability – to prohibit disclosure of any information in the report.

3. Under FOIA and the Trade Secrets Act, are the amounts of contractor overcharges (questioned costs and unsupported costs) identified by government auditors in completed audit reports "proprietary information" or a "trade secret" belonging to the contractor?

Contractor overcharges in an audit report do not constitute confidential commercial information subject to withholding by the government under exemption 4 of the FOIA. These are government numbers – as your questions states, "identified by government auditors" – and not data submitted by the contractor. I cannot conceive of a fact situation where assertions of overcharges would qualify as trade secrets or confidential commercial information that may (or must) be withheld from disclosure by the agency.

4. Under FOIA and the Trade Secrets Act, is a contractor entitled to redact information in government audits that it merely disagrees with, believes is misleading, or may find embarrassing?

There is, of course, no prohibition against a contractor's attempting to redact – or arguing that government should redact – information in an audit with which the contractor disagrees. The law does not allow the agency to rubber-stamp such an effort when the agency is asked to disclose the report. To the extent that the contractor, or the agency, believes that disclosure may be misleading or erroneous, this can readily be addressed by including with the report (as is done routinely in audits) any dissent or disagreement by the contractor. And, since the ability to prevent an audit's findings from being erroneous lies in the hands of the contractor, the contractor's standing to object is obviously weakened by its failure to have provided full and accurate information to the auditing agency.

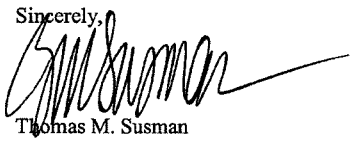
5. Are you aware of any instances in which contractor overcharges identified by government auditors have been legitimately concealed from the public under FOIA or the Trade Secrets Act?

Since I am not expert in government audits, my views on this question are not informed by vast experience in this area. To the best of my knowledge, however, audit reports are often completed by agencies and not released to the public, so there is no opportunity for the public to learn either of overcharges or findings of no overcharge. However, when there is no request by Congress, the public, or the press for disclosure (and in the absence of any agency policy, rule, or practice calling for routine disclosure), I do not believe that these instances can be properly categorized as concealment.

Through the years I have, as indicated above, taught a variety of courses and classes on FOIA and its implementation and have represented numerous clients who have endeavored to prevent disclosure of trade secrets and commercial information by state and federal agencies. I consistently have advised agencies, government contractors, including my own clients, and their counsel that overbroad claims of commercial confidentiality undermine the credibility of the business whose information is at stake and will usually prove counterproductive. Even with the Committee's recent experience, where the agency effectively rubber-stamped the contractor's confidentiality claims and only congressional involvement brought about disclosure, I continue to have confidence that both the contractor's business confidentiality interests and the public's interest in knowing how government funds are spent can be readily balanced under the FOIA and TSA.

I appreciate the opportunity to respond to your questions.

Sincerely,



Thomas M. Susman

Mrs. MALONEY. And I would just like to ask you, do you think these renowned experts are wrong that overcharges for the Government are trade secrets and should be redacted and kept secret in going to international auditors?

Mr. TYLER. Ma'am, as I stated, I am not a lawyer. I cannot discuss matters of law. But I can tell you what we were advised by our attorneys, and that is what I explained a moment ago.

Mrs. MALONEY. Well, Mr. Reed, in December 2003 you and the DOD comptroller held a press conference to announce the first $61 million in Halliburton overcharges, correct?

Mr. REED. That is correct.

Mrs. MALONEY. So after you held your press conferences in December 2003, discussing the $61 million in Halliburton overcharges, were you indicted for disclosing a trade secret when you disclosed the $61 million in overcharges?

Mr. REED. No, I was not.

Mrs. MALONEY. And has the Justice Department ever contacted you because of the release of this information?

Mr. REED. No.

Mrs. MALONEY. I really have not heard of anything that has changed between December 2003, when the Defense Department officials held an official press conference on Halliburton's $61 million in overcharges, and then their decision to redact the overcharges at a later point. The only difference is that it jumped to $200 million or more over the first $61 million. I find this very troubling.

I would respectfully request, Mr. Tyler, that after you read these three documents and the report from the CRS and from Dr. William Leonard, the director of the Information Security Oversight Office of the National Archives, if you still believe that overcharges are "trade secrets" of Halliburton and must be protected so that is true international auditors and the public do not have the ability to know about these overcharges.

I think redactions are abused many, many times, but I think this is the worst example of Government using a redaction. A redaction was used to hide fraud, misuse, and abuse of American taxpayer dollars. I find it reprehensible.

Mr. SHAYS. I thank the gentlelady for her line of questioning and I share her basic points. It is already testified that KBR decided what would be redacted and it is the position of this committee that this is information that should have been shared with the United Nations. We are asking now for how that decision was made and we are waiting for the Department of Defense to provide that.

Is there any more information, any comments before we get to our next panel? Mr. Bowen. Mr. Reed. Colonel. Mr. Benkert. Mr. Norquist.

Mr. BOWEN. Yes, sir, three quick points I would like to make.

Mr. SHAYS. Yes.

Mr. BOWEN. One, with respect to accountability regarding the $8.8 billion that was disbursed to the Iraqi government for their use, there are investigations going on within the Iraqi government relevant to fraudulent practices, so yes, there is accountability going on. During my last trip to Baghdad with the senior officials

in charge of investigation and anti-corruption within that government—and there are very, very substantial cases ongoing there—so yes, the accountability is being applied on that side of the ledger.

At the same time, I have also told them that if they have information that comes up in the course of their investigations that involves U.S. officials, that I want to know about it because we will pursue it. So this is not a dormant issue. This is an active issue that I was drilling down on just 3 weeks ago in Baghdad.

Second, the audit—I want to be clear. The audit in Hillah regarding the lost money, the $7 million in lost money, did not involve the commander's emergency response fund. It was the R3P program. We are auditing CERF and we will have that audit out in October.

Mr. SHAYS. Thank you.

Mr. Reed, any comments you want to make?

Mr. REED. Yes. In regards to the characterization "overcharges," I want to again emphasize that these are recommendations in an advisory audit report and that they are subject to the contracting officer evaluation of those recommendations along with other experts that he can rely on in reaching a final decision. Indeed, that final decision may say that these costs should not be paid, but it is important to recognize that we're an interim process right now.

Mr. SHAYS. I think the record is pretty clear on that, but it is good that you emphasized it.

Colonel, any comment?

Colonel DUBOSE. Sir, I can just tell you that the Corps of Engineers and the Southwestern Division is absolutely confident that through the diligent efforts of DCAA and the Corps contracting professionals and the others that are involved intelligence KBR contract will make sound contracting officer decisions leading to a fair and equitable settlement of these task orders that protects the public interest of both the United States and Iraqi citizens.

Mr. SHAYS. Thank you.

Mr. Benkert.

Mr. BENKERT. No, sir. Thank you.

Mr. SHAYS. Mr. Norquist.

Mr. NORQUIST. No, sir.

Mr. SHAYS. Thank you.

Let me just say to all of you, you have been very responsive to our questions. We thank all of you for showing up to this hearing. We thank you for your service to our country. I think that these are—this is not a 9 to 5 job and I know that you all work very hard in this effort and you care deeply about your country.

I would say to you, Mr. Benkert and Mr. Norquist, you missed an opportunity, unfortunately, to make your case in testimony beforehand which could have only served you and DOD well. I regret that you were put in the position that you were put in. I suspect you would have liked to have had a statement, and I appreciate that.

Thank you all for your service. Thank you for helping us do our job. We will get to our next and final panel.

I thank the gentlemen.

Mr. Tyler, I left you out. Thank you for responding in the end. We note that you were sworn in, and thank you for your testimony. It was very helpful.

Our second panel is Mr. Stan Z. Soloway, president of Professional Service Council [PSC]; and Mr. Richard Garfield, Dr. Richard Garfield, Columbia University.

Mr. Garfield, you can stay standing because I will swear you in. I think you can feel comfortable, gentlemen, before I swear you in, that we will not take this long with this panel.

Please raise your right hands.

[Witnesses sworn.]

Mr. SHAYS. Note for the record both our panelists have responded in the affirmative.

I would say to both of you your testimony is as important as the first. You have the advantage of knowing what our questions are. You have the advantage of hearing the first panel. So if you choose to read your testimony or ad lib or do a combination of both, because you know what we are interested in, I want you to feel free. Your full statement will be part of the record, and we thank you both for being here. We obviously thank you for your patience. It is nice to have you be at the first panel so you get a sense of what concerns us. Thank you.

Mr. Soloway.

STATEMENTS OF STAN Z. SOLOWAY, PRESIDENT, PROFESSIONAL SERVICES COUNCIL, ARLINGTON, VA; AND RICHARD GARFIELD, DR.PH./R.N., COLUMBIA UNIVERSITY

STATEMENT OF STAN SOLOWAY

Mr. SOLOWAY. Mr. Chairman and members of the subcommittee, on behalf of the nearly 200 member companies of the Professional Services Council, the principal national association of companies providing a full array of services to the U.S. Government, I appreciate this opportunity to offer a few perspectives and some context on many of the challenges associated with contracting as it relates to both DFI and the broader issues of Iraq.

Our membership is unusually diverse in terms of both company sizes and their respective capabilities, and nowhere is this diversity more evident than in Iraq, where numerous member companies and thousands of their employees are currently engaged in providing military support, reconstruction, and developmental assistance.

Today I would like to divide my comments into three very brief segments: where we have been, where we are now, and perhaps most importantly where we need to go in the future.

Looking back, two early decisions made by the U.S. Government have had a continued and seminal influence on much of what has transpired with regard to contracting in Iraq. First was the decision to move immediately into reconstruction and development, even as a significant military operation was still underway. Never before have we simultaneously conducted a major military operation—in this case the largest sustained operation since Vietnam—and in the same physical space been engaged in the reconstruction of the national infrastructure, as well as a wide variety of economic and other developmental activities.

Normally these would be sequential operations, but in Iraq they are concurrent. That decision is the principal reason we have such large numbers of contractors in Iraq today, and that for the first time many of those contractors are now seen and must be treated as "contractors on a battlefield." It is also the principal reason for the unprecedented need for private security for non-military entities, and it has played a significant role in many of the issues surrounding the cost and availability of insurance, particularly under the Defense Base Act. It is also at the heart of some of the confusion, sometimes poor coordination and communications between and among the numerous entities operating in Iraq, their stateside counterparts, the combatant commanders, contractors, and I would suggest even the Congress.

At about the same time, the U.S. Government decided to apply all of our traditional procurement rules to contracts in Iraq utilizing appropriated U.S. dollars. Many of the concerns that have emerged since then, including many that you have discussed today, can be traced directly to that decision. Indeed, as has been demonstrated through our work with our member companies and our colleagues in GAO, the Inspector General for Iraq, the Defense Department, State, USAID, and others, the business processes and models that dominate our traditional procurement and contracting regimes are often wildly out of alignment with the realities of an environment such as that in Iraq, which is probably the most non-traditional environment in which we have ever operated.

This misalignment is evident in debates surrounding the frequency of full and open competition, the use of fixed price contracts, cost accounting and growth, and more. Whether it be the impacts of requiring third-party liability insurance on 30,000-gallon fuel tankers in an active war zone, or whether to allow company personnel more frequent breaks and relaxation than usual from the extraordinary tension and intensity of working in Iraq, too many disputes have been driven by this disconnect.

Moreover, the situation has been exacerbated by what, frankly, appears to be an unusual push for instant oversight rather than allowing the process to operate as it does so well and as I believe it is continuing to do. One government official reported at one point that there were more oversight personnel in Baghdad than contracting officers.

Further, it seems that every mistake or error in judgment that has been made with regard to Iraq is assumed to equal that of a major scandal. As such, the mission environment has, we are told, suffered. As that same Government official said to me, people are not only afraid of making a mistake; they're afraid to make a decision.

This is not to suggest that this committee back off its oversight responsibilities. Indeed, they are an integral part of our system of checks and balances. It is, however, to ask directly and respectfully that as issues emerge you do everything possible to understand the underlying causes, circumstances, and more so that the ensuing disposition of those issues is as balanced and thoughtful as possible, which brings me to where we need to go in the future.

Over the last 2 years PSC has made a series of recommendations to the Defense Department and others that we believe remain es-

sential next steps. First, we have recommended that the Defense Department award a multiple award contract for all private security requirements in Iraq from which individual companies needing such services could procure them on a reimbursable basis. We believe this would help ensure that the security companies operating in Iraq have the qualifications and experience that is needed.

Short of letting such a contract, we believe DOD should either create a list of approved security providers or minimally establish a common set of standards for security services that all firms must meet. Interestingly, this push for standards has come as much from our member companies who are procuring such services and the security firms with which we have worked.

Second, we have recommended the Defense Department enter into a master Defense Base Act insurance contract of the type already in place for the State Department and USAID. By way of comparison, basic Defense Base Act insurance, which is legally required, rates for State and USAID are all under $5 per $100 in payroll. For all others who have to buy this coverage on the open market, the rates are routinely in double figures and have at times been as high as $25 or $30 per $100 in payroll, and clearly that is not a sustainable cost.

Third and most importantly, teams of experts from the agencies, the Congress, the oversight community, and industry must put their heads together to both simplify and clarify existing procurement rules as they would or should apply in an environment such as this and identify any significant new rulemaking that is needed. Many of the disputes between companies, their contracting officers, auditors, inspectors general and others stem principally from disagreements over what the rules do or do not allow or the guidance under which a respective work force is operating. In this environment, this is particularly difficult given the occasionally gray areas of our processes.

For example, if the DCAA audit guidance for pay premiums for private sector personnel is 155 percent, it really does not matter to an auditor reviewing the cost if the market conditions are driving higher pay premiums. He or she must base their analysis on what the audit guidance says.

The same is true of how to handle the payment to deployed work forces idled by security constraints or to how to overcome cost accounting shortfalls driven by a lack of acceptable cost accounting practices among Iraqi firms and more.

We can go a long way toward alleviating further disputes and I believe addressing the concerns of this committee if we are able to reach agreement on how better to align these crucial business processes in such a difficult environment.

Mr. Chairman, at the end of the day I think we all agree on the need for a system that affords maximum accountability while also reflecting the realities on the ground. We must assess Iraq on the basis of those realities rather than on our preconceived notions of what should have happened or has happened elsewhere or what happens normally. Our ability to find that balance will play a significant role in the degree to which companies operating in Iraq today will be able to again step up to support our missions, be they military, construction, or developmental. And since they are per-

forming functions that are almost entirely in the purview of the private sector, we place an imperative to achieve that alignment sooner rather than later.

Thank you for your time. We look forward to answering any questions you might have.

[The prepared statement of Mr. Soloway follows:]

TESTIMONY
of
STAN SOLOWAY
President, Professional Services Council

Before the
Committee on Government Reform
Subcommittee on National Security, Emerging Threats, and International Relations

June 21, 2005

Introduction

Mr. Chairman, members of the Subcommittee, thank you for the opportunity to testify before you today. My name is Stan Soloway, president of the Professional Services Council (PSC). PSC is the principal national trade association representing companies providing services of all kinds to virtually every agency of the federal government. Our membership is uniquely diverse in both company sizes and areas of specialization. Nowhere is this diversity more evident than in Iraq, where thousands of employees of numerous PSC member companies, large and small, are working day in and day out to support our military, rebuild the country, and provide vital economic, health and other developmental assistance and support.

Indeed, it is the very diversity of PSC member company involvement in Iraq that highlights the single most unique, but all too often ignored, aspect of the Iraq experience. In Iraq, we are in the midst of the largest sustained military operation since Vietnam. We are also simultaneously engaged in the physical reconstruction of the nation's infrastructure and a wide range of development assistance activities, from financial systems to education, from the rule of law to agriculture and health systems. Normally, these missions would be sequential in nature, but in Iraq they are being performed concurrently and often occur in the very same physical space. This situation has created the unprecedented and necessary presence of contractors and helped to sharply define some of the overarching contracting and business-related issues we are here to discuss today.

I want to note at the outset that, by their very nature, "lessons learned" often focus constructively on mistakes and problems that need to be fixed. My testimony today will be no different. But I offer this testimony in the context of extraordinary admiration for our men and women in uniform and for the thousands of contractor employees who, at

great personal risk, are in Iraq today supporting the military and working to help that country on the road to a sustainable economy and democracy.

Overall, the quality and professionalism of military and non-military operations in Iraq has been very high. This is especially true given the overwhelming surge requirements, operational tempo, scope of operations, and dollars involved. Certainly, there have been some very visible issues, but given the scope of the concurrent operations, those issues have been relatively few and some turned out to be far less significant than initial impressions suggested. This is a testament to both the government's acquisition community and the commitment they bring to their jobs and, to the companies involved, the vast majority of which have long histories of strong, focused, and exceptional mission performance, often in areas of conflict and high risk.

It is estimated today that some 300 contractor employees have been killed in Iraq, primarily as a result of the insurgency. Unfortunately, Iraq is not unique in this sense. Just two weeks ago, five employees of one of our member companies working on a project in Afghanistan were gunned down by radical elements there—incidents that receive far less attention and coverage than do the tragic daily events in Iraq.

Finally, it is important to remember that while some might try to use the Iraq experience as an excuse to make broader political points about the relative roles of contractors and government civilians, that debate is not relevant in Iraq. For the most part, the roles being played by contractors in Iraq are not new, but are consistent with the manner in which the U.S. government has utilized contractors around the globe for decades. The bulk of the work being performed by contractors in Iraq is simply not work that would or could otherwise be performed by the military or by U.S. government civilians. This is particularly true of the reconstruction and development initiatives but it is also true of contractors supporting the military. For reasons of cost and mission focus, for nearly two decades the military has increasingly been focusing its resources on its core warfighting mission and turning a wider array of support functions over to private sector performance.

Since several months prior to Operation Iraqi Freedom, the Professional Services Council has been deeply immersed in the acquisition issues and other challenges faced by companies under contract to support one or more of the concurrent operations in Iraq. We have held numerous meetings with our member companies to learn from their experiences and help them sort through the issues where possible. We have conducted more than a dozen briefings for members of Congress and staff to provide context and perspective surrounding the issues that have been prominently raised since the advent of the war. We have also worked closely with the oversight community, particularly the Government Accountability Office and Mr. Bowen's staff at the CPA-IG, now SIGIR, to share information, observations, and insights. In addition, at the request of the then-Commander of Army Materiel Command, PSC conducted a joint Iraq contracting lessons learned initiative with AMC and other Army and DoD representatives. We have also maintained close and continued communications with our colleagues at USAID and the State Department.

Through all of our work on Iraq contracting, the messages and lessons have been remarkably consistent. PSC has not spent a lot of time directly on the Development Fund for Iraq issues. We have found, however, that the lessons and observations that have emerged from our other work are common across companies and agencies, and believe that they have relevance to your deliberations here and for future deliberations by the Congress.

Overview: Understanding the Environment

It is important to understand the environment which the U.S. and its coalition partners immediately encountered following the fall of Saddam Hussein's regime. For it is only in the context of that actual environment that we can understand fully the business and contracting challenges we have faced.

The Iraq the U.S. moved into two years ago was a nation with little or no infrastructure and no market economy. Every branch of each of the country's banks operated as an independent company. There were no inter-bank transfers and no credit cards. Checks were virtually non-existent and all payments for materials and labor were, and still mostly are, in cash. Communications were almost impossible—indeed, even today, less than 15% of Iraq's population of over 27 million people has phone service. There was no internet, and the electrical grid was designed to provide limited electricity to only selected and favored locations. The challenges associated with these limitations and inadequacies have been further complicated by a constantly changing threat environment which itself drives costs and continually evolving security requirements.

The point is simple: nothing most of us have experienced is like what those in Iraq are experiencing on a daily basis. Not only is this an environment that is completely alien to our domestic or even normal international marketplace expectations, but it may also be the most difficult environment in which, collectively, we have ever attempted to do the work of reconstruction and development. As such, our traditional norms of measuring progress, costs, and more, are not adequate. We must assess Iraq on the basis of the realities on the ground, rather than using our preconceived notions of what should happen there or has happened elsewhere at a different time.

It has thus been most dismaying to many of us in this field--in both government and industry--to see some of the Iraq contracting issues become such political footballs. Mr. Chairman, the effect of this dynamic has been to create an environment in which, frankly, mission focus has been too often supplanted by fear; an environment in which one government contracting officer told us people are not only afraid of making a mistake, they are afraid of making a decision. This is not a healthy environment.

As such, if there is one plea I would make to the committee today it is this: oversight is crucial and congressional oversight is a fundamental element of our system of checks and balances. But please be mindful that Iraq was and is not a "normal" business environment; that our traditional measures of effectiveness and success often do not work

there, and that we need an acquisition community -- in both government and industry -- ready and willing to be innovative and do hard work in the harshest of environments. Mistakes are inevitable. Yet few rise to the level of intentional abuse or fraud. Unfortunately, in the current environment, just the opposite assumption seems to be the norm. This is a disservice to the committed professionals in both government and industry who are doing their best in the most difficult of circumstances, and it has a very harsh effect on our acquisition system. This subcommittee can play a major role in helping distill the debate and ensure a more balanced approach to the issues before us.

Applying Traditional Procurement Rules in a Most Non-Traditional Environment

The decision in 2003 to apply all traditional U.S. procurement and other related laws to contracts utilizing appropriated U.S. dollars was far more significant than most people realize. This decision was intended to ensure good stewardship of taxpayer dollars during a time of rapid and expanding expenditures. By adopting traditional U.S. standards, the decision was also designed to help ensure that the U.S. acted appropriately while in another country.

I am not here to either support or criticize that seminal decision, but given the reality of the Iraq environment, it is critical to understand the consequences, costs, and unavoidable limits connected to it. Indeed, a significant portion of the issues and concerns raised by this committee and others can be traced to that decision.

Let me offer one example. We all remember the controversy surrounding the price of fuel in Iraq shortly after the fall of the regime. While cost analyses continue, several facts have been largely ignored in the public debate about those costs as compared to potential, alternative sources of supply. Of course, the certainty of availability of those alternative sources was a major concern, but here we are focused solely on the cost comparison.

First, for security reasons, the U.S. required its contractor to utilize American drivers for its fuel tankers. That requirement alone drove labor costs up by orders of magnitude. Second, the U.S. required the contractor to only utilize trucks that were compliant with U.S. Occupational Safety and Health Administration requirements, as opposed to local vehicles that were not subject to such rigorous standards. That drove equipment costs up. Finally, in keeping with its commitment to be a good steward and visitor, the U.S. required that the contractor carry third party liability insurance on its fuel trucks. Stop for a moment and think about the costs of liability insurance for a 32 thousand gallon fuel tanker in a war zone.

Was the decision to require insurance correct? That is a decision only the U.S. government can make. But when such acquisition or requirements decisions are among the most significant root causes for cost build-ups, it is wholly unfair to ignore those facts when assessing the costs charged by the contractor. This example is but one of scores we have seen where the imposition of our traditional federal procurement rules surrounding business responsibility, subcontracting goals, accounting, auditing, and more, have come

into direct conflict with the realities on the ground. Unfortunately, we have watched with significant dismay as departures from the norm such as this are too often unfairly treated as major scandals.

In addition to overlaying traditional procurement and accounting rules in an environment that simply might not be able to support them, there also remains a lack of clarity and alignment around the flexibility that the rules provide. This lack of clarity has led to numerous disputes and disagreements, even among and between government entities. Moreover, those disputes and disagreements have often been most sharp when they involve individuals or organizations that are on the ground in Iraq trying to reconcile issues with those who have remained stateside.

For example, it is wholly unrealistic for companies to be required to track, with traditional granularity, all of the spending by its first, second and third tier subcontractors. In fact, Iraq, like many other countries, does not follow generally accepted cost accounting standards. Nor is it reasonable to expect companies to always get multiple competing written bids for work in an environment where the market economy differs sharply from our own and in which written bids are quite rare. Yet acquisition policy requirements in these areas have frequently sparked sharp differences of opinion between the companies, their contracting officers, and the government's auditors or other oversight personnel. One cannot blame the auditors—they are simply following the rules, as they exist. Nor should one blame the companies or their contracting officers, for they are simply trying to do the best they can to execute their missions in a highly volatile, very non-traditional environment.

This is just a sampling of the often complex and difficult conflicts between our traditional rules -- and expectations -- and the environment in Iraq. In many cases, these differences have been at the root of congressional and others concerns, but have not achieved the level of understanding we think is so important.

Acquisition and Contracting Infrastructure Challenges

The training and preparation of the acquisition workforce has, in many areas, been wholly inadequate for these missions. This is less true of the acquisition personnel directly supporting the immediate military contingency operations—many of whom specialize or have experience in this area. But it has often been proven true in the cases of otherwise capable and committed acquisition personnel who were assigned to the mission with far too little advance preparation or training. It has also continually been an issue with various oversight personnel.

The situation is exacerbated by a limited acquisition infrastructure. While much attention has been paid to the Army's logistics support contracts and alleged issues with their management and oversight, the irony is that most of the people we worked with on our assessments agree that there are problems of acquisition infrastructure. In reality, they were far less pronounced in the Army's direct troop and logistics support operations than was the case for other requirements, whether they were contracted for by the Army Corps

of Engineers, the CPA, State, USAID, or other entities. For example, at one point only about a dozen of the 120 contracting billets in the CPA had been filled. Not too long ago, it was reported to us by government acquisition officials that there were more oversight personnel in Baghdad than warranted contracting officers.

The House of Representatives has begun to focus on this issue through the proposed creation of a "Contingency Contracting Corps" as set forth in the House version of the FY06 National Defense Authorization Act. PSC does not believe the creation of a new organizational entity is the right answer. The Army and others are already adjusting their personnel structures to meet the needs of the field; but the real problems with the acquisition infrastructure have not been on the contingency side, but on the sustainment and support side for ongoing reconstruction and development activities—which is not addressed by the legislation. We believe the answer lies more in reviewing and adjusting personnel policies, including the hazardous duty benefits that might accrue to civil servants called on to deploy, rather than creating new, potentially overlapping organizational structures or trying to artificially segment continuous work between contingency and maintenance.

In addition to the overall acquisition infrastructure, many concerns arose relative to the even more limited in-country presence of the acquisition community. Many contracts, including the Army and Air Force primary logistics support contracts, are administered stateside where the awareness of immediate needs and pressures and the on the ground realities are simply not as acute. Time, distance, and communications challenges greatly complicated mission execution. Indeed, where program managers and contracting officers were co-located in country, these problems were significantly reduced.

Moreover, time and distance challenges also created a real lack of clarity around lines of authority. Simply put, in what circumstances and through what process could the combatant commander (CoCom) on the ground simply redirect his or her support—military or contractor—to meet an immediate need? It might seem obvious that the CoCom is the authority in charge, but in fact this is not recognized in the current acquisition regulations. DoD has recently issued some new acquisition regulations designed to address this issue. Those regulations are helpful but remain incomplete, are inconsistent with other departmental policies, and are applicable only to DoD, even though many federal agencies and their contractors now have a presence "on the battlefield."

This leads me to the first recommendation that emerged from our lessons learned initiative last summer. We must immediately create a team of experts from DoD and the military departments, State, USAID, GAO, the Defense Contract Management Agency, the Defense Contract Audit Agency, the relevant Inspectors General, AND INDUSTRY, to review all of the current acquisition and auditing rules and regulations relating to contracting on what is essentially a battlefield, and come to agreement on a concise set of rules and guidelines for everyone to follow. If we can gain consensus on the acquisition rules and the requirements process, we can and will be able to better focus scarce

resources, heighten our ability to conduct appropriate oversight, and avoid many future problems and disputes.

The Role of Private Security Forces

Beyond the immediate acquisition and contracting challenges, there is also a set of issues involving personnel deployment, security and insurance that I would like to briefly address. Personnel security is a paramount concern for contractors operating in the region and has been the focus of a lot of discussion, and occasional misinformation, in Congress, the media, and the agencies. The threat in Iraq has created an unprecedented private security requirement, principally because it is wholly impractical, and possibly inappropriate, for the military to provide force protection for the thousands of non-military reconstruction and development support projects underway.

For the most part, the military is directly providing the requisite security for its contractors. Meanwhile, companies performing under USAID, CPA, State, or other U.S. government contracts, or contracts let by other countries or entities, including the U.N., are generally required to provide their own security. It is here that the unprecedented nature of the situation in Iraq—the three concurrent operations—has one of its most obvious impacts. Was this a traditional, sequential process, security needs on the ground would not be nearly as acute as they are today. This is in no way a criticism of that decision, to undertake reconstruction and development operations without delay, but we must recognize that the decision underpins the need for such large contingents of private security, and the numerous ways in which the current security environment impacts mission, cost and performance.

In addition, the threat environment has been continually changing. The insurgency has used a wide array of tactics that require constantly changing security plans and procedures. Security procedures have also slowed daily work or added many hours to a working day -- depending on the security situation on a given day. As a result, the pace of reconstruction and development is dramatically impacted. Furthermore, the security environment itself has created major tensions and disputes in cases where company personnel have to "stand down" for days at a time due to the threat environment. Under normal circumstances, the company would only be paid for hours actually worked. But when security factors halt work, the workforce, particularly non-Iraqi workers deployed to the country, MUST still be paid. Here, too, the application of our traditional rules remains in conflict with the security realities on the ground.

With regard to the costs and role of private security, PSC's members are the companies that, for the most part, are procuring private security to protect their workforces in Iraq. Those companies generally report positive experiences with the security companies they have utilized. Among our nearly 190 member companies, only a couple offer private security services as a line of business. Nonetheless, it is significant to note that there is fairly clear consensus among the security companies with whom we have worked, and other PSC members operating in Iraq about the key issues involved in contractor security.

First, there is concern among the established security companies, as well as the contractors procuring security services, that there is not a clear set of standards and qualifications required across the board for security companies operating in Iraq. Recognizing this as an emerging issue, PSC recommended to DoD two years ago that the Department do one of three things to facilitate and ensure the quality of security services:

(1) Create a multiple award contract managed by the Department of Defense through which contractors could procure their needed security services on a reimbursable basis;
(2) Create a qualified bidders list from which companies could select their security providers; or
(3) At a minimum establish a set of standards and qualifications against which security providers could be measured.

Regrettably, none of these actions have been taken. We are pleased that legislation is pending in the House Armed Services Committee that identifies this as a key area for attention and would require the establishment of such standards. It is important to stress that the strongest push for standards is coming from the established security firms themselves, in concert with the companies procuring those security services.

Second, although it has improved in recent months, the communications and coordination between the military and private security forces is still not what it should be. Until recently, there was essentially no ongoing means by which private security providers could coordinate intelligence or threat information with military commanders. Over time, the military has become more adept at pushing information out to the contractors' security community, but there has never been a truly effective two-way communications process. As such, we have recommended the creation of joint security planning and coordination teams and processes that would enable this pressing issue to be addressed. We applaud the House for adopting this approach as part of the FY06 National Defense Authorization Act.

Third, a number of issues have arisen with regard to other contractor force protection needs. Cases have come to our attention in which contractors arrived in country to perform work on DoD contracts without the knowledge of the combatant commanders who were responsible for their security. The coordination and flow of such information is essential and the lack of such coordination and flow at times created significant problems on the ground.

Here, too, Congress is beginning to step in through provisions in the House version of the FY06 National Defense Authorization Act. The bill would require contractors to, in effect, register all of their in-country personnel with the combatant commander, and would require the combatant commander to develop a force protection plan based on those inputs.

There is no question that combatant commanders need to know how many people are in their Area of Operations. However, we oppose the overly detailed reporting requirements

in this provision because creating a direct reporting system to the CoComs from potentially scores of contractors with data and information that changes daily will likely be more complicated and confusing than it is helpful.

Rather, PSC recommends that the relevant agency contracting activities assume the responsibility to notify CoComs of contracts that are being let, the estimated number of contractor personnel involved, their likely locations and duration in country, etc. This will provide CoComs with a steady flow of consistent and necessary information without requiring the creation of what could be a most confusing and ineffective reporting process. It will also greatly facilitate the formulation of requisite force protection policy and plans for the contractors "on the battlefield."

Further, there are cases in which contractors performing under military contracts have been required to procure their own security services, despite a policy that states otherwise. It may make eminent sense for the contractors to be given that responsibility in certain cases, but DoD policy must be written in such a way as to acknowledge such departures from the norm.

Finally, with regard to security, we recognize that there are a number of unresolved issues surrounding such things as arming civilians, U.S. criminal jurisdiction abroad, and civilians in Iraq. The Congress appropriately sought answers to a number of predicate questions in this area through last year's defense authorization bill. The reports are due to Congress shortly, therefore it would be premature for Congress to take any additional action until they are delivered and fully assessed.

A number of key steps have already been taken to address the issues of criminal jurisdiction, contrary to the claims of some people that civilians operate in Iraq with impunity. Last year, Congress enacted amendments to the Military Extraterritorial Jurisdiction Act to provide expanded criminal jurisdiction over civilians performing on any DoD contract. The State Department has continued what is known as CPA Order 17, essentially a surrogate Status of Forces Agreement, which declares that non-Iraqi civilians can be remanded to their home country and prosecuted under their home country criminal laws for acts committed in Iraq. Order 17 will, we hope and trust, be incorporated into a formal Status of Forces Agreement with the Iraqi government—an agreement that could not be entered into prior to June 28, 2004, because there was no sovereign government in the country.

On the issue of arming civilians, we are also aware that there has been a significant unofficial change in DoD policy. During the conflicts in the Balkans and as recently as two years ago, it was virtually unheard of for civilians to be authorized to carry weapons. Today, such authorizations are routine. However, based on our discussions with our member companies, the State Department, USAID and DoD, it appears that very few companies have actually acted on this authority, since doing so creates a whole new set of challenges and liabilities for both companies and the government. We have urged DoD and other agencies to ensure that their procurement rules and contract clauses are consistent in this area.

Insurance: Issues of Cost and Access

There are a number of key issues regarding insurance. First and foremost, it is important to recognize that under the Defense Base Act any U.S. civilian performing on a U.S. government contract anywhere overseas must be provided with basic workers compensation coverage. For many companies, this coverage has been both expensive and sometimes very difficult to obtain. In addition, the basic coverage includes numerous exclusions under standard war risk hazards provisions that must be made up somewhere. The government through the War Hazards Act assumes some of those exclusions. But for circumstances deemed by the risk community to amount to a war risk, but not declared as such by the government, the gap remains and filling it is both difficult and expensive.

Several years ago, both the State Department and USAID established their own DBA insurance programs that utilize bulk buying to keep costs low and participation is available to of all of their contractors and subcontractors. DoD does not have such a program. This alone has driven substantial costs for the Department. By way of illustration, the guaranteed worldwide rates for basic DBA coverage for the USAID program is fixed annually, now at about $2.15 per hundred dollars of payroll; at the State Department the fixed rate is slightly higher at closer to $4 for most work and $5 for construction contracts which, by nature involve greater workers compensation challenges. For contractors having to buy basic DBA coverage on the open market, rates are routinely in double figures, and have gone as high as $25 or more per hundred of payroll. Regardless of the existence of these department-wide insurance programs, it should be clear that some access and cost issues continue to be present by virtue of the usual war risk hazard exclusions and the evolving threat environment. Even with guaranteed rates for basic DBA coverage, overall insurance coverage is adjusted substantially upward when exclusions are imposed and supplemental coverage is required. In some cases, the very availability of coverage comes into question.

PSC has recommended that DoD consider creating a program for its contractors similar to that currently in place at State and USAID. We understand that the Army Corps of Engineers is attempting to do just that for its contractors. We believe that in establishing such a program, over the long run the Department or Defense's and the government's overall interests will be best served.

Beyond DBA coverage, there are numerous other insurance issues with which companies must contend. Their ability to attract and retain the right people with the right skills to some extent requires that they be able to provide those individuals and their families with at least reasonable and competitive protections. Among these protections would be coverage that we generally consider routine, such as AD&D, and others that are anything but routine, like kidnap/extortion coverage. For work in Iraq, both are very expensive. Yet these are costs of doing business that are well outside the control of the contractors. We have worked with the Defense Contract Management Agency (DCMA) on these issues over the last two years and appreciate the degree to which DCMA is trying to reconcile seemingly huge costs with on-the-ground realities. However, disconnects and

disputes continue between other oversight entities that question these costs and contractors who have little choice but to respond to the market as it currently exists.

Other Personnel Policy/Practice Challenges

Similarly, there have been numerous disputes over the application of contractors' workforce policies. One example is the permissibility of vacation or leave. Because of the intensity of the environment, a number of companies try to give their workforce more frequent opportunities for rest and relaxation than is their norm under state-side contracts. Clearly, such breaks are vital to morale and performance and help limit turnover. But all too often the oversight community challenges these practices because they are contrary to some interpretations of our "traditional" rules as they are applied to work performed under "normal" circumstances.

Contrary to what some believe, while hazardous duty pay is clearly the norm for civilians deploying to Iraq, it is almost never so significant that those individuals can spend a year in country and then return home to retire. For these people, such incentives, including appropriate insurance, are not unimportant, but their service is far more often tied to what they see as their professional role in life.

Finally, all civilians deploying to Iraq must have all requisite vaccinations and be given Personal Protective Equipment (PPE) including a Kevlar vest, helmet, chem-bio suits, etc. However, particularly early in the operations, vaccines and some of the needed PPE were simply not available. Frankly, some contractors thus could simply not comply with the contractual and situational requirements. In addition, while all contractor employees are required to process through Civilian Relocation Centers, or CRCs, en route to Iraq, the general consensus is that much work remains to be done to ensure that the CRCs are providing contemporaneous information and an efficient processing system. As I stated earlier, it is our hope that better advance planning and coordination between all affected government organizations and the contractor community will help alleviate some of these differences, inconsistencies, and difficulties.

Conclusion

Mr. Chairman, I have only touched on some of the major, and very difficult, issues that we all grapple with when dealing with contracting in Iraq. The issues are complex, highly nuanced, and in many cases unprecedented. No one should be surprised that in a mission this large, in such a difficult environment and involving tens of billions of dollars in expenditures, errors will be made. The sheer complexity, tension and pace of the concurrent missions are such that mistakes are inevitable. Moreover, the nature of this kind of operation and work mandates that, even as we rightfully demand ethical behavior and overall integrity on the part of government and contractor personnel alike, we recognize the limitations and costs associated with our traditional views of stewardship and accountability.

The Professional Services Council would welcome the opportunity to continue to work with you, the members of this committee and your staff as you continue to explore these and the many other issues associated with contracting in Iraq. Thank you again for the opportunity to appear here today. I would be happy to answer any questions.

Mr. SHAYS. Thank you, Mr. Soloway. Your verbal testimony was excellent and your written testimony which is longer, as well, is really quite excellent. It is very helpful to the committee. Thank you a lot for it.

Dr. Garfield.

STATEMENT OF RICHARD GARFIELD, DR.PH./R.N.

Mr. GARFIELD. Thank you for inviting me. What I can present to you is somewhat different. I have worked in humanitarian affairs in Iraq, among other countries, for the last 9 years. I was a consultant to UNICEF and the World Health Organization and to the Ministry of Health in Iraq prior to and during the CPA period and since then.

Mr. SHAYS. Let me ask you this. Does that mean that you worked in Iraq or you were a consultant?

Mr. GARFIELD. Consultant. My normal employment is at Columbia University.

Mr. SHAYS. Right.

Mr. GARFIELD. But I get leaves for short periods, although after the invasion I was there for 3 months to help to reactivate health services.

Mr. SHAYS. Right. So you spent a good time in Iraq?

Mr. GARFIELD. A good deal of time.

Mr. SHAYS. Do you know how many visits to Iraq you would have had?

Mr. GARFIELD. In the last 9 years, I guess eight visits. I believe that is right.

Mr. SHAYS. And one 3 months. Thank you.

Mr. GARFIELD. I cannot address directly DFI funds. I can address the function of the ministry and the CPA in that sector in which I worked.

Mr. SHAYS. That would be helpful.

Mr. GARFIELD. And that is all I can do, so I think it provides some insight to the question even of the funds.

There were enormous problems in the constitution of CPA, particularly I can only speak specifically about the health sector. Having been there when we expected CPA to arrive, the first dilemma that we had was that the team of people in CPA for the Health Ministry did not arrive until 9 months after Baghdad fell, which created a tremendous vacuum of authority. It was after 7 or 8 weeks we pretty much believed that they were not going to come, and were surprised when actually the team did arrive.

Of greater dilemma to those of us who were on the ground, me at that time as World Health Organization staff member, but working with a spontaneously constituted group of Americans who met at the palace, most of whom were military medical physicians who had leave from their specific duties to help organization the health services——

Mr. SHAYS. Now tell me who you were hired as a consultant for? I'm sorry, sir.

Mr. GARFIELD. At that time?

Mr. SHAYS. Yes.

Mr. GARFIELD. In Baghdad for the World Health Organization.

Mr. SHAYS. Thank you.

Mr. GARFIELD. On the basis of my having worked there as a consultant to these U.N. organizations prior to the change in government.

Mr. SHAYS. Gotcha.

Mr. GARFIELD. And knowing the people in the Ministry of Health.

Mr. SHAYS. OK.

Mr. GARFIELD. When the CPA team arrived, we were surprised to find that not one of the members of the CPA team in health had worked outside the United States before, and not one member of their team had a master's degree in public health or higher degree in that field or related fields. So they were essentially an entirely green team with no experience at reconstruction or at reconstituting health services in areas of conflict, much less in areas where there had been many years of deterioration of services. In other words, they were really not in the position to establish normal accounting procedures for their activities. There were two people in country who were, one who was the head of the AID team for the country and the other was the head of the health contract letted by AID to APT Associates. Both of these individuals were—I do not know what the right term is, but were kicked out by the CPA team as they constituted alternate sources of authority and experience in the field.

So when I heard the term from the previous panel several times of lessons learned, it should come as no surprise that there were lessons learned because if you had no experience at this and suddenly you're running a country of 27 million people you would learn some lessons, but this is not the ideal situation in which to learn lessons, and we are way behind the curve in doing so.

In working with some joint contracts and projects with World Health Organization and the CPA team, it quickly became apparent to us that they did not know budgeting of health service activities and were not capable of assisting the Ministry of Health either in establishing a budget, which the ministry had not had——

Mr. SHAYS. "They" being who? I'm sorry?

Mr. GARFIELD. The CPA team.

Mr. SHAYS. Right.

Mr. GARFIELD. Ministry of Health, like all ministries of the government of Iraq, essentially had been command economy ministries where normal budgeting procedures had never been in place. You were told what to do. They were good at carrying out orders, but not in determining what the resources were and figuring out how to utilize resources for maximum benefit or for specific outcomes.

Unfortunately, the CPA team which it had been assumed was coming in to do this did not do that, was not capable of doing that. What CPA was able to lead was a visioning exercise for the ministry, and when I was last in Baghdad in January for the Ministry of Health the senior staff of the Ministry of Health was still talking about our vision and visioning. They still did not have—and this relates very much to Mr. Kucinich's comment—when we turned over authority to Iraqis that we picked, we did not leave systems in place for them to do the accounting. We had not shown them the kind of ways that we normally do it in the United States. And we chose individuals in some sectors, including the health sector, who

also had no experience at running health systems and had no degrees in doing so. So it was virtually a guaranteed failure in terms of being able to follow the money.

Given these weaknesses at the central level, it was my personal observation that the funds disbursed through the commander's emergency response funds, although we cannot account for them in some cases, actually were utilized much better than the funds that we can account for through the CPA health sector.

Mr. SHAYS. I'm unclear as to why you think we could do it better through the military account versus——

Mr. GARFIELD. My observation is that the funds—personal observation is that funds tended to be used better, not that the accounting was better, but that——

Mr. SHAYS. I understand.

Mr. GARFIELD. These people, although they also had no training in determining what would be the priorities, in fact, responded to local political demand. Common sense was better than lack of training and isolation in the green zone in order to figure out what some of the basic needs were. So I actually was very supportive of the commanders and their funds, and I wish we were able to provide them some basic training so they could make a better job of determining what those needs would be.

The comment from the prior panel of people spending only a year in passover I think responsibility is very relevant, and it was not stated so clearly but it was implied that the passover responsibility from one individual to the next after a year often occurs without any physical contact between a person in responsibility. There may be 2 or 3 weeks after somebody leaves, somebody new comes and does not have a piece of paper to followup on, so we continue to have tremendous difficulties in providing services and doing things the way that we would normally do them, including to account for where the funds have gone or where the files physically may be.

In the health sector today there is only one individual from the United States from CDC who is tasked to the State Department in order to followup all concerns and activities in support, including training for Ministry of Health staff. That individual is there only on a 6-month contract, and it is believed that post will not be filled again, so it looks like we're just going to leave them to their own devices when this individual is done. And one individual certainly cannot do the job appropriately.

So the problems in finding out where the funds are certainly make sense when you consider these limitations.

[The prepared statement of Mr. Garfield follows:]

June 20, 2005

Testimony of Richard Garfield

To the Subcommittee on National Security, Emerging Threats, and International Relations

On the Efficiency and Effectiveness of the Development Fund for Iraq in the Health Sector

Dear Members of Congress and other Interested Parties,

Background and Expertise

My name is Richard Garfield. I am a Professor of Nursing and Coordinator of a World Health Organization Collaborating Center at Columbia University, and a Visiting Professor at London School of Hygiene and Tropical Medicine.

I work in countries with wars or economic sanctions to assess humanitarian conditions. This has sometimes thrust me into political situations, but I am an epidemiologist and nurse, not political scientist. There are few developing countries for which we have a clear, real-time picture of who is at risk and how to reduce that risk during crises. I mainly work with national authorities to improve their ability to manage the crisis, improving data collection and its use to make scarce resources go further

I have done this in Cuba, Haiti, Yugoslavia, Afghanistan and Liberia for national governments and UN organizations over the last two decades. It was in this context that I first visited Iraq in 1996. Since then I have visited Iraq almost every year to assist UNICEF, the World Food Program, and the Iraqi Ministry of Health. I evaluated the quality of mortality studies and created independent estimates of mortality changes, evaluated the overall humanitarian impact of the Oil for Food program, participated in research on income and living standards in northern Iraq, and carried out an analysis of nutritional status during the 1990s.

After the 2003 invasion, I assisted the World Health Organization, UNICEF, and the American NGO International Medical Corps to assist in reconstruction, manage reactivation of health services, and prepare the post-Oil for Food UN program. He collaborated with the CPA and the Ministry of Health to reactivate the health system throughout the post-war summer, authored the post-war 'Watching Brief' on Health of the World Bank in the summer of 2003, designed a child survival strategy for USAID in Iraq in early 2004, and participated in research to identify changes in mortality since the 2003 invasion. During my most recent visit to Iraq, I assisted the Ministry of Health to

redesign health worker training and human resource development in January of this year. I am also a member of the Humanitarian Assessment group of the Independent Inquiry Committee into the UN Oil for Food Programme which is soon to conclude an assessment of the effectiveness and efficiency of the Oil for Food Program in alleviating the country's humanitarian crisis during 1997 - 2003.

I met most of the people working for the CPA in the health sector and observed their activities and priorities. I had to deal with them in some manner as an on-the-ground consultant for the World Health Organization, and as one of two authors of the main analysis of the health system at that time, the 'Watching Brief' prepared by UNICEF, the World Bank, and WHO. I thus an in a position to comment on the efficiency and effectiveness of the CPA's work in health, but not specifically about their budgeting or spending of DFI funds as it was never clear what activities were based on these funds.

Composition of the CPA Health Team

There were serious deficits in the composition of the team. Perhaps most importantly, the team did not begin to arrive in Iraq until 9 weeks after Baghdad fell to the Coalition. The vacuum of leadership that occurred during those 9 weeks greatly weakened the initiative of the reconstruction effort. We learned of the appointment of Mr. James Haveman to the post of Senior Health Advisor to the Ministry of Health from an article in the New York Times. No one at the Ministry of Health and no one among the informal military medical leadership group at the palace were able to confirm if this appointment was indeed valid, and as weeks passed without any forward movement the general view was that the appointment would not occur. We truly were surprised when after more than two months, Mr. Haveman appeared with a team in Baghdad.

Among members of that team, there was not a single individual with an advanced degree in public health. I think not one member of that team, including Mr. Haveman, had ever lived outside the United States. This lack of experience and expertise was another blow to the widespread desire among Iraqis to fix the health system and improve the health of the population.

CPA Work in Health

Aspects of Mr. Haveman's leadership style represented a further blow to that effort. Mr. Haveman saw to it that the only other US citizens in Iraq in an official capacity were dismissed from their posts. This included Jack Thomas of US AID, and Mary Patterson of the firm ABT Associates, the main US AID health subcontractor. These individuals each had many years of international health project management experience in the Middle East and elsewhere and could have been key in developing efficient and effective program priorities and administration. Instead, Mr. Haveman had the support and advise mainly of clinicians from the DoD, none of whom had run or built health systems. Inevitably, the work of the CPA would then focus on running hospitals and providing medicines. While these activities are essential, they would have less impact on improving the health of the Iraqi people at that time than a focus on community health

education, outreach for basic health promotion programs, and the elaboration of financial management, systems planning, and pharmaceutical administration systems appropriate to a middle income developing country. The failure to focus on these issues mirrored the major problems of the Oil for Food program over the prior 8 years, where commodities were delivered but training, maintenance, and management of the health system had deteriorated enormously. The aspiration of making the health system appropriate to the health conditions of Iraq could not be achieved by the CPA team.

The mystery surrounding CPA functioning did not end when the team arrived. Little of their work appeared to result from consultation with Iraqis, and few announcements of heir decisions ever appeared, even within the Ministry of Health. Although the team did take up posts in the Ministry of Health building, there was virtually no use of mass media, then growing rapidly to either share decisions with the public or to reach the public for health promotion. Not only was a great opportunity lost, but most people in Iraq were left in the dark about the interests and actions of the US in health. More of their publicity was oriented toward to US than toward Iraqis.

One area where this would have been important was with regards to user fees at ambulatory clinics. Such a system had been setup four years before the fall of the Hussein regime. These user fees paid supplements to physicians that kept them at work and provided for the purchase of cleaning supplies, bandages, oxygen, and other essential local goods. The normal way to examine this situation would have been to identify the role of these fees in unit budgets, identify alternative sources of funds, and determine who didn't use health services because of these fees. Instead, and without consultation with knowledgeable Iraqis, Col. Garner simply abolished the fees, throwing clinics into disarray as great as the recent looting. Doctors didn't come to work without the accustomed salary supplements and a crisis in oxygen supply resulted. CPA was forced to quietly withdraw the abolition of user fees, only to find them attacked and prohibited, and then reestablished, under subsequent Iraq administrations. CPA should have provided the example of well informed studies leading to policy analysis on user fees; instead Iraqis continue to consider this strictly a political matter. Lacking expertise, under CPA, indeed, it did remain a political issue alone.

The private sector in health had grown a great deal during the years of sanctions. It was not integrated into the public medical care system, nor was coordination with it developed. Both of these would have required a higher level of policy expertise than existed among the CPA.

One o the biggest issue for CPA in health was 'corruption'. The term was never defined, and Iraqis had a very different understanding of what is and was corrupt than the American did. Anti-corruption efforts were highly moralistic rather than administrative. They provided little to improve the management and oversight in a period when supervision of work declined and punishments for not obeying orders disappeared. In this context, the robbery of medicines and other goods in the health system flourished. The first-post CPA Iraqi Minister of Health believed that he largely rooted out corruption in

the medicine supply system, while people in the system say it is far more corrupt than under Saddam.

More important, but virtually unaddressed, was the mis-utilization of medicines. It appears that the majority of antibiotics, for example, are given to patients whose condition does not warrant the use of antibiotics. Use of antibiotics per capita in Iraq is higher than in the US. The solution to this problem would have involved training and retraining, supervision, and monitoring. Since steps weren't made in this direction, the system still hemorrhages a massive amount of the goods for health at a time when the people can least afford to be without medicines. The elaboration and distribution of treatment algorithms, chart reviews, and in-service education seminars could have greatly improved training of health workers, but it never occurred. The value of medicines lost this way far outweighs the amount lost to corruption, either before or after the 2001 invasion.

Lacking planning and management skills, the CPA led staff at the Ministry of Health in 'visioning' exercise. Even during my visit in January of 2005, senior staff described the vision of an affordable, equitable system, but hadn't begun to develop skill in basic planning tools. Our Iraqi counterparts need and deserve to learn these skills and we Americans have more of these skills than anyone.

CPA frequently described the 'bad old days' under Saddam and described the present with an 'everything-is-coming-up-roses tone. Critical analysis did not go on and CPA staff misunderstood the limited data generated by the health system. Little attention was devoted to improving the collection and analysis of health services data, though this should have been among the CPAs first tasks.

In the context of this limited skill and focus, it was inevitable that both the utilization and the documentation of the use of DFI funds would be inadequate. Even the request from the CPA for $900 million for the health sector, as part of the $18.6 supplemental appropriations for Iraq, arrived in Congress in a shocking form. The document was a total of 8 pages, full of typos, repetitive paragraphs, and partial sentences. No justification was provided in that document for the funding amounts requested. At that time I thought, 'If one can't make a reasonable request for funds, one certainly will not monitor or report on their use adequately.' This is exactly what seems to have occurred.

TO their credit, the CPA team remained engaged in Iraq and highly dedicated to their work throughout their tenure. CPA set as a main health goal the halving in one (and then two) years of the Infant Mortality Rate (IMR). Yet they never knew what the IMR was, and never established plans to measure it! It could have been a centerpiece of the work of the health system, but instead became merely a rhetorical goal. CPA used a survey that had been carried out 4 years earlier, using data 6.5 years earlier, as their assumed current IMR. Anyone with minimal skills in demography knows that this was an invalid indicator of the current rate. Even worse, they never put in place a plan to monitor mortality rates to see how well the country was achieving their main goal. CPA never overcame its own rhetoric to get passed 'happy stories' for US consumption to identify valid health

monitoring methods. We have no reason today to believe that the IMR is any lower than it was when the invasion occurred.

Health Conditions Today

The only major effort to assess living conditions since UNICEF's MICS survey in 2000 was carried out last year under contract to the UNDP. The Norwegian Statistical Agency carried out a large scale representative sample survey to assess living conditions in Iraq in spring and summer of 2004

The survey showed that most people do now have access to health services provided by the Government, and most of those services are better stocked and staffed than they were before 2003. The quality and effectiveness of services are not very good, however. Popular dissatisfaction is common (38%). Most children going to a clinic with diarrhea are given antibiotics (68%) rather than the oral dehydration fluids (37%) they should receive. While 98% of births are attended by a nurse, doctor, or midwife, death due to childbirth continues to be quite high (193 per 100,000 live births).

10% of households are overcrowded. 6% of homes have been damaged by wars. Only 60% have regular access to clean water (down from 90% in 1989). The percentage of the population with piped connections for waste water disposal increased in the early 1990s, but the proportion with treatment of that water was small in the beginning of the period and approached zero by 1996. Little recovery occurred through 2003, and this improvement was largely lost through looting and the loss of electricity generating capacity in the months following the 2003 war. In the 2004 survey sewage was observed in the street near 39% of all houses.

Malnutrition among children under five years of age has declined from the very high rates observed in 1996, but shows much less recovery since 2000 and remains much higher than it was early in the crisis, in 1991.

	1991	1996	2000	2004
Acute Malnutrition	3.0	11.0	7.8	7.5
Underweight	9.0	23.4	19.5	11.7
Chronic Malnutrition	18.7	32.0	30.0	22.7

Deaths due to the war in recent years were estimated at 18,000-29,000. This represents about 56 deaths per day due to war. This is about half the 101 conflict-related deaths per day found in The Lancet study last year, but more than double the 22 deaths per day recorded by the Government of Iraq via its hospital reporting system.

occasional large scale surveys give little more than a glimpse. On-going monitoring of a few sensitive indicators would tell us much more, but no such monitoring existed under the Hussein government, nor was such a system set up under CPA administration.

Conclusion

Security and the economy are the major determinants of Iraq's ill health. Thus, the major challenges to health in Iraq could not have been solved by better use of DFI monies or by constituting a more qualified CPA team. These failures nonetheless left Iraq in worse condition, and with less ability to face to these enormous challenges, than were possible. Mis-utilization of DFI resources and inadequate leadership by the CPA represent enormous lost opportunities in the reconstruction of Iraq.

Mr. SHAYS. Thank you very much.

Mrs. Maloney, you have the floor.

Mrs. MALONEY. Thank you.

Mr. Garfield, could you describe your experiences before the CPA and after the CPA?

Mr. GARFIELD. Could you make it a bit more specific.

Mrs. MALONEY. In Iraq, your activities in health services before the CPA and after the CPA.

Mr. GARFIELD. My activities before CPA were in assessment of health conditions. I assisted to carry out or to analyze several of the large servers that were done with which we determined what the needs were, and also assisted in identifying the training needs for staff in the Ministry of Health.

Mr. SHAYS. If I could just interrupt to ask, when you say "we," could you make sure you say who we is. Is that the World Health Organization in that case or——

Mr. GARFIELD. Each year is different. It was World Health Organization, World Food Program, or UNICEF, one of those three.

Mr. SHAYS. OK.

Mr. GARFIELD. After the invasion my responsibilities for UNICEF in the first 6 weeks after the fall of Baghdad was, together with staff from the World Health Organization and the World Bank, to do a comprehensive base analysis of the health system and the health situation in order to set priorities. This is a document that those three organizations did together. Those three organizations were represented by myself and one other individual. That was called the Watching Brief, and it remains sort of the base document for which Ministry of Health is doing what little planning is going on.

And after that I worked for the World Health Organization in Iraq assisting staff in the Ministry of Health.

Mrs. MALONEY. In your written testimony you wrote that the post-war period saw massive corruption, particularly in the medicine supply chain, and you were saying that this corruption was actually worse than under Saddam Hussein. Can you give more details in that corruption? And how do you know that it was worse than what it was under Saddam Hussein?

Mr. GARFIELD. You will see that some of this is impressionistic, but there are structural relationships that helped to give some limitation to that. The funds from the Oil-for-Food Program under the prior government of Iraq, relatively speaking, are a crystal clear window. We know how much money came in in contracts in the health sector, and there were observers who went to the central warehouse and to distribution points to identify if, indeed, those medicines, specifically in the area of medicines, which was the largest single dollar value—still is—for imports, where they went. So we largely know how much and where the medicines went and where they were distributed.

There were some structural elements of corruption in the system that were known. There were several levels at which people were on the take. Essentially, it was a system, I would say, sort of run by the Mafia, making sure that nobody else took because the officials were taking, and it appears to be up to about 10 percent of the value in that sector.

When CPA came in and those individuals were no longer in charge of the medicine distribution system, which is usually the highest cost accounting sector within the health sector in a developing country, accounting for 60 to 70 percent of the value of imports, which is to say currency exchange, the CPA identified early on the central warehouse and regional warehouses as a major bottleneck and source of potential corruption. And corruption was dealt with as a moralistic issue.

The CPA intended to close down the public distribution system for medicines altogether and privatize it, and when they tried to do that all medicines stopped moving, and so very quickly the central public system was re-established. But those people who were keeping tabs on things because they were in charge and on the take were no longer there, so everybody kind of took a box of medicines home with them through the back door. There was very little oversight, whereas under the Saddam Hussein government there was excessive and parasitic oversight.

We found many more of the publicly purchased medicines in private pharmacies afterwards. It is widely believed—in fact, I do not know anybody who is not of the opinion that with those limitations and oversight taken off and very little supervision by central authorities as security situations worsened, that the medicines did not flow out like a sieve.

Mrs. MALONEY. Just in closing, earlier today we heard about massive amounts of money, stacks of $100 bills. You're saying that the medicines were not being replenished, the doctors were not being paid. Did you see cash being handed out in the medical system to doctors or to get medicines for the people or did you see any of that large sums of money going into the medical facilities to help the people in Iraq?

Mr. GARFIELD. Yes. I did not say that medicines were not gotten out and that salaries were not paid. In fact, the payment of salaries was probably the best thing we did. Salaries were multiplied about fivefold from where they had been prior to the invasion, and an awful lot of Iraqi staff were happy. This actually goes to your comment, Mr. Shay, about disbanding the army and creating unhappy people, because in the health sector health workers became happier and went to work more often in spite of increasing insecurity because of the establishment of central payrolls and the payment of reasonable salaries.

In spite of the pilfering of medicines through the system, in fact, the dollar value of medicines being purchased after the invasion was three or four times higher than where it had been under the Oil-for-Food Program. There was just a whole lot more money coming in for this. So, in fact, hospitals became better staffed, better supplied, and also health centers.

There are continuing problems, but these are secondary problems.

Mrs. MALONEY. My time is up. Thank you.

Mr. SHAYS. I thank the gentlelady.

Mr. Soloway, I have primary questions for you, but, Dr. Garfield, I want to react to a few things.

First, I went into Iraq the first time in April but then went back in August with a non-government organization and it was very

memorable because we went to visit some hospitals, and there were no supplies in August 2003. And one of the doctors had family members who lived in the United States. One was a doctor. The doctor I met was bitter. He was bitter that he had no supplies. He was bitter that he had no oxygen. He stayed in the hospital in part because of his protection because he had—he acknowledged that they had limited oxygen in surgery. Some of his patients died from lack of supplies. He did not feel safe. They have a malpractice system that works different in Iraq than here. In Iraq if you do not like what the doctor did you kill him. Here we just sue the hell out of them. So he stayed in the hospital, but he was really bitter about what he did not have. And he worked morning, noon, and night, and he would periodically go home for lunch with his family.

I will never forget that. And he could contrast it to how his brother was living, I think in Chicago, as a doctor. It was amazing just to talk with him.

I also just want to say I react to your talking about how under Saddam the system worked a little differently. It worked a lot differently. He had an Oil-for-Food Program in which his margin of corruption was smaller. He made more off of the goods that he bought. He overpaid for goods and got a kickback of about 10 percent. And you're right. It was the Mafia. He was allowed to cheat the system. If anyone else did, they could be executed. That is a disincentive to try to cheat Saddam, though many got their little piece.

I do not disagree with anything you said and I find your testimony very helpful. It is just a sense that I have that I guess this triggers this question. Would we have been better to keep all—is it your statement that we kept all the people in place who were providing health care but not necessarily keeping the ministers who ran it, given they were political appointees? Or did we also keep them in place, as well?

Mr. GARFIELD. It was some of both. We actually tried a lot of experiments with a lot of lessons learned. First, an attempt to keep a vice minister had been a Bathist, which the rest of the ministry staff refused and so that person was thrown out. And then there was the clean sweep of all Bathists, throwing out the bath water along with the Bathists.

Mr. SHAYS. Right.

Mr. GARFIELD. Which went too far. The reason we did not have O–2 at that time is that there had been user fees in place for 4 years for people who received ambulatory care, and CPA abolished the user fees, supposedly in order to create a benefit for people, but those user fees is what purchased the consumables like bandages, cleaning supplies, and oxygen. So the country was in a crisis with a lack of oxygen because the hospitals did not have the money to buy the oxygen, and that policy was then reversed and reversed and reversed. Four times the policy was started to get rid of user fees and then re-establish them, get rid of them, and they have just been reestablished again.

These are the kinds of sort of mindless innovations that occur when people do not have any experience or knowledge about the field and are making policy.

Mr. SHAYS. But there were people before the war that did have experience?

Mr. GARFIELD. And most of those people are two levels or three levels down from the ministers, and it is those individuals who are running everything now. Nothing would run without them because they are just enough below the radar——

Mr. SHAYS. But they were not empowered?

Mr. GARFIELD. They were not and they are not in power. They are the directors——

Mr. SHAYS. I do not mean in power. They were not empowered. They were not given the authority to be able to make certain decisions and so on, correct?

Mr. GARFIELD. For the most part that is correct, but even more importantly they were not given training to do their jobs in the way that they could so that the whole system could be at least twice as efficient.

Mr. SHAYS. All you're doing is you triggered the question would we have been better off to run it the way Saddam did it or the way we ultimately did.

Mr. GARFIELD. We would have been better off if we engaged in public discussion with people who knew rather than making decisions in the green zone without experience and going step by step rather than by fiat and wide sweep.

Mr. SHAYS. It is why I favored the non-government organization model, the Save the Children, the Mercy Corps, the International Red Cross, the other organizations that were making in the field hiring Iraqis. I thought their money was spent better.

Mr. Soloway.

Mr. GARFIELD. Just one last point on that?

Mr. SHAYS. Sure.

Mr. GARFIELD. It was some of the experienced people in the Ministry of Health who we got rid of that those organizations hired.

Mr. SHAYS. Very interesting.

I wish more Members were here to hear your testimony, Mr. Soloway—both of yours—but it is part of the record and it will help this committee. The issue of Kellogg, Brown and Root as the poster child for the issues of questioned costs and unsupported costs which is referred to differently by some, it is your point, I think, and I'd like you to elaborate, and you gave me some examples. Maybe you could give me some more.

But what—and this is why, frankly, I think Kellogg, Brown, and Root make a huge mistake having redacted this, because it implies they do not have a meaningful story to tell that would say, for instance, I'm gathering from your testimony that there might be a dispute. I wish I had asked the first panel this. When you started to testify, I was thinking that is the one area we should have gotten into a little more, what exactly would questioned costs be.

I am imagining it would be their claim that they had this amount for security and the auditor saying, "Well, we will pay that amount but not the amount—we will pay a certain amount, but we will not pay the amount that you want." They come back and say, "Listen, this is what we ended up paying them, so we would like to be in reverse." They say, "Well, you might have paid them too much." I mean, that is one.

First, is that an example that you were citing? And, second, are there others that you could give us as an example of disputed costs that do not necessarily represent trying to get one over on the Government or, you know, corruption?

Mr. SOLOWAY. I think your example is an excellent one and the cost in question can be anything, but let me make two comments, one about Kellogg, Brown and Root specifically and this issue of redaction, just to make sure everybody is clear on the issue, because I think there is a couple of things that have sort of been shoved off to the side, and then talk specifically to the question of other examples, because I will use non-Kellogg, Brown and Root examples that I think are a little bit more evident.

Just to be clear, the Trade Secrets Act issue that was raised here and redactions and the role of the Defense Department and the contractor, the contractor says to the contracting officer, "These are the things I believe to be proprietary trade secrets." The contracting officer then has the authority to overrule the contractor, so the Defense Department does have the authority to get involved in that.

Mr. SHAYS. It appears they chose not to exercise that.

Mr. SOLOWAY. And they may have had very good reasons. I do not know what was redacted. I cannot speak to the specific redactions.

Mr. SHAYS. OK.

Mr. SOLOWAY. I think that there is an issue here——

Mr. SHAYS. So you would say to staff, one of the questions that we should be asking is did they with, for instance, Kellogg, Brown and Root, accept all the redactions or did they choose not to accept some of them? That would be a question I would like to write in.

Mr. SOLOWAY. The other distinction, the quick distinction I was going to draw—and I think Mr. Reed touched on this, or one of the other witnesses—there is a difference under the law between what the Congress is entitled to and what an IAMB or non-U.S. entity would be entitled to, and I think there is an interesting distinction there that needs to be very carefully addressed.

As I understand it—I am not a legal expert—as I understand the Trade Secrets Act, it would actually probably allow you as a Member of Congress to see an unredacted document.

Mr. SHAYS. We have the unredacted.

Mr. SOLOWAY. But it cannot be publicly exposed. But it would not necessarily allow the IAMB, because it is not a U.S. entity, it is not a U.S.——

Mr. SHAYS. I understood the——

Mr. SOLOWAY. So there is an issue that I think the negotiation needs to take place. I'm not taking either side. I just want to make sure the context was clear for everybody to understand.

Mr. SHAYS. I accept that it may technically be right, though I wonder whether or not, given the relationship we had with the IAMB, given that they had given us this responsibility and required there be transparency, it raises the question whether we should have asked anyone who contracted to waive this part of it.

Mr. SOLOWAY. And the discussion with a broader community in advance to figure out how we are going to achieve the outcome we're trying to achieve.

Mr. SHAYS. Right.

Mr. SOLOWAY. I think that is a fair discussion to have. I do not disagree with you on that.

Mr. SHAYS. Right.

Mr. SOLOWAY. But to the specific question of other examples, let me use an example of another company that had so-called unsupported or questioned costs that are still in dispute, and by the definitions that some other members of the committee have been using today would be called overcharges. This company was one of the first companies into Iraq. In fact, they were in the health sector. They faced an enormous spike in insurance costs, which many people did, as you know, as you have heard I think over the last year or two. There has been this big issue with insurance cost and access. At that point in time and to date their customer, the agency for whom they are working, has said those are not fair and reasonable costs, we are not going to pay those insurance rates, and so they have had to pay them themselves, the difference out of their own pocket, but have been in a dispute with them saying this is what the market was driving.

In subsequent contracts, that same agency is now identifying that higher rate as what they will pay for insurance because they have now figured out that is what the market is driving, but they still will not pay the company that had the initial contract because in their initial contract the estimate for insurance was lower because no one anticipated this market spike, if that makes sense.

That is an unsupported cost somebody would call, or a cost in dispute. Someone might say the company has overcharged because they have billed this. It is not an overcharge. This is a discussion of what the market costs are and a very legitimate cost issue. That is the kind of thing that often gets worked out in the negotiations that Bill Reed was referring to, so that would be another example. We see them all the time.

If I could just add one context here, Dr. Garfield talked about the common sense of people who were working in the local community and having local contact and the kind of thing that we would all assume to be part of this process. Those common sense decisions very often are directly in conflict with our laws about procurement, cost accounting, and so forth. The way you deal in an economy that has no market economy, you do not get competitive written bids, yet you might know somebody in the health sector who you know locally has expertise, knowledge you want to use and you contract with them through a non-traditional manner. It is a different kind of environment, a different kind of market. So it might make very good management sense, but it might also put you in direct conflict with our procurement rules. That is the point I was making in my testimony.

Mr. SHAYS. I'm missing your last point. Please explain it differently.

Mr. SOLOWAY. The economy in Iraq is not what we would consider a market economy.

Mr. SHAYS. Right.

Mr. SOLOWAY. For example, we do not have written——

Mr. SHAYS. I understand it is not a market economy. OK.

Mr. SOLOWAY. And written bids, for instance, are very rare.

Mr. SHAYS. Right.

Mr. SOLOWAY. Our marketplace, we rely on competition and written bids. We have overlaid our traditional procurement rules on our appropriated dollars that are being spent in Iraq on contract, so as a contractor working in a small outpost or in Tikrit or wherever it might be, as I am subcontracting or identifying local capabilities to help me do my job, in theory I am under the regular U.S. procurement laws, but there is no market economy and I cannot go out and get seven different written bids and a fixed price on a contract or expect cost accounting from my subcontractors locally that I would require of a U.S. company operating in a normal U.S. environment, but it may be the only way I can achieve the mission.

I may only have access to those folks in the region who a tribal elder—a lot of it is tribal, it is sectarian, it is family, whatever it might be. It could be even the old Mafia structure. That is how capabilities are identified and brought to bear. Yet, when an auditor comes in—and we have had cases of this where the auditors have come in and wanted to see cost buildups to see what the subcontractors spent at every step of the way, which is our normal rule of accountability. We cannot provide it. Companies cannot provide it because it is simply not available.

Mr. SHAYS. If a company had to pay off someone to get their work done in Iraq, would they be breaking the law in Iraq? I know they would in another country, but within Iraq——

Mr. SOLOWAY. I do not know the answer to that question. I do not believe they would be breaking the law there. And I'm not even talking about law-breaking, if I could give you one quick example.

Mr. SHAYS. I was going to the next thing, but what do you want to say? And then Dr. Garfield I want to respond.

Mr. GARFIELD. The answer is no, they would not break a law.

Mr. SHAYS. If it was another country would they have been? We do not allow for political payoffs.

Mr. GARFIELD. Right.

Mr. SHAYS. But in Iraq it would be legal?

Mr. GARFIELD. There would be no law against it. Well, it would be if it was a U.S. citizen, because I do not believe we can engage in that, but if it was an Iraqi to an Iraqi we——

Mr. SHAYS. Before you make your point, let me make sure I understand. The question I asked was if you made—you paid a bribe in order to conduct your business in Iraq, you say it is not in Iraq it is not against the law. But, for instance, if Sikorski, a company, wants to get the contract in some country like Turkey and they are competing with France and France is very willing to pay someone off, the Sikorski—United Technologies cannot make that bribe. What's the difference? Why in Turkey——

Mr. GARFIELD. National law and international law.

Mr. SOLOWAY. Actually, the Foreign Corrupt Practices Act applies to any U.S. citizen or entity doing business anywhere in the world.

Mr. SHAYS. Right.

Mr. SOLOWAY. They cannot enforce a law on the French or on an Iraqi.

Mr. SHAYS. Right. But why an American doing business in Iraq, why could they make a payoff?

Mr. GARFIELD. An American could not. I'm sorry. I thought you were asking if it was illegal in Iraq.

Mr. SHAYS. OK. So they could not do that. And obviously they could not ask for reimbursement on a payoff?

Mr. GARFIELD. Correct.

Mr. SHAYS. OK. Fair enough.

Mr. GARFIELD. But you can put the guy's brother on the payroll. There have to be balances to make things work.

Mr. SHAYS. I hear you.

Mr. SOLOWAY. Let me give you a concrete example of what we're talking about.

Mr. SHAYS. Sure. But first what question are you answering?

Mr. SOLOWAY. The first one you asked about examples of how our traditional rules do not necessarily work in that lack of a market economy.

Mr. SHAYS. Right.

Mr. SOLOWAY. One of the companies we work with was contracted to build a security perimeter around a facility and were told to extensively utilize Iraqi labor and Iraqi subcontractors.

Mr. SHAYS. Right.

Mr. SOLOWAY. Which is the intent, when people say "X amount of money went to U.S. companies," they do not count for what is being flowed through to the Iraqi economy. They went out and found a company through local contacts and whatever and brought them in, negotiated a price, and paid them on a progress basis. They gave them a certain amount down, and like you would do your house, at certain spaces they gave them more money until the job was done. Everybody seemed relatively happy with the work.

Several months later when there was an audit of the contractor, routine audit, the auditor, following the guidance that they have—I mean, this is not the auditor's fault—wanted to know how many bidders they had, and the answer was, well, we found one capability so we brought them in. So in effect, in our language, it was a sole source contract.

OK. Well, that is fine. We understand it is not a market economy. How many man hours went into this? How much was the concertina wire? How much was the concrete? How much were the shovels, the pick axes, and so forth? The answer was they did not know because in the Iraqi economy there is no system. They do not have a cost accounting process like we would have.

That led to an extensive discussion. They ultimately settled it with the auditors because it was them trying to get a mission done in the context of the economy they were in, as opposed to under the rules that we have. So it was a conflict. We have seen many of those occur. Some of them have been settled and, frankly, some of them are not. They are very difficult. That is why we have made this recommendation that we need experts from industry, from government, the oversight community, the contracting community, the Congress to sort of review our rules and regulations and come up with a set of rules and regulations that make sense in this kind of an environment that we all agree to, that this is as far as we can apply, these are the limits to what our rules will allow, this is how we are going to do cost accounting, and so forth, because it is a very, very difficult situation. You have people charged with

oversight, people charged with getting a mission done, and sometimes in some marketplaces or certain environments the two do come into conflict.

Mr. SHAYS. You know what I am struck by? Obviously there may be other factors, but if I was a contractor and I was being accused of overcharges, I would be writing this committee to request to be before the committee because they have and others have a story to tell. You educate the American people and they accept it, unless there is concern that they do not have a good story to tell. That is another issue. But, frankly, if I was doing business and I had to deal with everything I have seen in Iraq in the eight times I have been there, I think I could explain pretty clearly why I have these costs and why I think I should be compensated and why it would, you know, make me mad as hell to have someone call something an overcharge on something that is a dispute. It is just curious to me why.

Mr. SOLOWAY. I think from our perspective one of the great concerns that we have had is we have seen this issue get hotter and hotter around contracting and allegations and assumptions of wrongdoing every place you look. In addition to the impact it has in the field, I think that it is very notable that if you listen to Mr. Bowen as he testified today and has in the past in other reports, Mr. Reed and other DCAA reports and others, what is remarkable is, given the amount of money that has been expended on contracting in Iraq in a very short time in the most difficult environment we have ever been in, they, themselves, have said many times by and large they have been impressed about how well the process has worked, both front end and the back end of it.

I will say that I believe Brown and Root did testify before the full committee at some point—I believe it was the full committee—in a rather extensive discussion of their charges and their role and so forth.

Mr. SHAYS. You're right. You are right. You're absolutely right.

Mr. SOLOWAY. Most companies that I am familiar with do enjoy the opportunity to come before the committee when they had the chance to explain in context what is really going on, because this really is a truly unique environment.

Mr. SHAYS. You are correct. I was not at much of that hearing, if at all, so you are definitely right, they did testify.

I just want our professional staff to ask a question, and then we are going to have some votes and we will call it quits.

CHIEF INVESTIGATOR. Very quickly, Mr. Soloway, the IG acknowledged that there were extraordinarily challenging threats in the environment that CPA was working in. He did not seem to take that into consideration in insisting that there should be standard accounting procedures, and we were interested to know what your thoughts were regarding that.

Mr. SOLOWAY. I have two comments. One is I think that I am not in a position to judge what the CPA did or did not do. I think that clearly in hindsight if the IG and other experts have identified gaps in what was the planning, then clearly even the lessons learned work that we have done, we have certainly identified advance planning gaps that goes into what we do better the next time. So I cannot really judge from that perspective.

I would say that—and this goes also to Dr. Garfield's point—the human capital issue here and the availability of the right skills at the right place at the right time is a much bigger issue I think than we have paid attention to, whether it is medical skills and people with public health expertise, contracting and acquisition skills, and so forth. There are tremendous issues here about getting people deployed.

Mr. SHAYS. I need to move along because I have a vote. Let me ask you, is there any last point, Dr. Garfield or Mr. Soloway, you'd like to put on the record?

Mr. GARFIELD. No.

Mr. SHAYS. Thank you. Both of your testimony has been excellent and very helpful. I thank you again for your patience and appreciate your response to our questions, as well. Thank you all very much.

With that, this hearing is adjourned. And may I thank the transcriber for her patience.

[Whereupon, at 2:15 p.m. the subcommittee was adjourned.]

[NOTE.—The Office of Inspector General, Coalition Provisional Authority Audit Reports, No.'s 04–009, 05–004, 05–008, and 05–006, may be found in subcommittee files.]

[Additional information submitted for the hearing record follows:]

Responses to Questions for the Record for Hearing on "The Development Fund for Iraq: U.S. Management of Oil Proceeds and Compliance with U.N. Security Council Resolution 1483," June 21, 2005

Q1

Line 1567 | Mr. Kucinich. I understand that, but here's what I am trying to get at: would that one location be the only place where the money was distributed from? Or were bundles of money taken to other distribution points, or were bundles of money given to other individuals who would then distribute that cash?

Line 1576 | Mr. KUCINICH. May I ask, Mr. Chairman, I appreciate what the scope of your study was, but, Mr. Chairman, it seems to me if we have the IG here saying there were not proper managerial, financial, and contractual controls, I think it would be instructive to this committee to understand exactly how the money was distributed, because then we could come to an understanding of whether or not, you know, it was just simply a lack of controls or whether or not this committee could fairly conclude that many was lost, stolen or corruptly misused. I mean, is that a fair assumption?

Line 1586 | Mr. BOWEN. I would be happy to provide you with that answer.

Response for the Record: The Coalition Provisional Authority Comptroller, located in the Presidential Palace in Baghdad, was the central distribution point for the Development Funds for Iraq (DFI). Division level agents for the four disbursement regions (North, South, South central, and Baghdad) would commute to the palace and receive cash from the comptroller, and sign for the cash. These agents would place the cash in trash bags, boxes, gym bags, backpacks, coolers, footlockers, etc. and transport the cash to their respective regions. Once in the region, division level agents would transfer various amounts of cash to their paying agents. The number of paying agents varied depending on the size of the region. Division level agents and paying agents would distribute the cash to contractors and grant recipients.

Our report [SIGIR Audit Report No. 05-006; Control of Cash Provided to South- Central Iraq; 30 April 2005] was limited to a review of management documents for the South Central Region. Our review showed that a total of $48 million in cash was disbursed for contracts and $21 million in cash for grants over the period October 2003 to June 2004.

Q2

Line 1613 | Mr. KUCINICH. Who determined whether a private contractor should be paid in cash or in some other form? Who made that determination?

Line 1616 | Mr. BOWEN. It was a matter of necessity, and it depended on the nature of the circumstances. There would be no one determination of that. If the private contractor was an Iraqi contractor in country, that contractor was paid in cash. If it is a U.S. contractor, then electronic funds transfer can happen back this side of the world.

Line 1622 | Mr. KUCINICH. Were there any cases in which U.S. contractors were paid in cash?

Line 1624 | Mr. BOWEN. Yes there were, but I cannot recite them for you right now. I'd have to get back to you.

Line 1626 | Mr. KUCINICH. Could you give us a list of – provide this committee with a list of all the U.S. contractors who were paid in cash?

Line 1629 | Mr. BOWEN. I will research the issue and get back with you on that [get that information for you].

Response for the Record: SIGIR cannot provide a comprehensive list of contractors that were paid in cash from the DFI account. As reported by SIGIR [SIGIR Audit Report No. 04-009: CPA Comptroller Cash Management Controls over the DFI, 28 July 2004; SIGIR Audit Report No. 05-006: Control of Cash Provided to South- Central Iraq; 30 April 2005], the records do not exist due to the following reasons:

1. The DFI account manager and paying agents in the South-Central Region did not fully comply with applicable guidance, and did not properly control, account for, and turn in DFI cash assets.
2. SIGIR only audited the South Central Region for disbursements of DFI from October 2003 to September 2004. We did not audit cash disbursed throughout the entire country.
3. The list of contractors we were able to compile, during our audit, contains U.S. contractors, Iraqi contractors, and others. The list is limited and we cannot distinguish among the various nationalities of the contractors just by reading the names, making it impossible to produce even a limited list of U.S. contractors paid in cash. If such a list were made public, it would create a significant security problem for those individuals and companies.

Although the CPA Comptroller had the capability to issue checks and electronic funds transfers and, in a few cases, these types of payments were arranged, almost all contractors who received DFI funds as payment for contract work were paid in cash. We were told during our audit that cash payments were made because Iraq lacked a banking system that could process checks or electronic funds transfers.

Q3

Line 1925 | Mr. RUPPERSBERGER. My time is up, but I would like you to get back to me on what person or individual or department determined that we should hire Northstar to monitor, because I think that is the beginning of where this has started. The problem started with that and it has continued on.

Line 1930 | Mr. BOWEN. Yes, sir.

Response for the Record: The determination was made by Ms. Patricia G. Logsdon, Contracting Officer for the Coalition Provisional Authority. A solicitation for these

services was issued September 13, 2003 with a closing date of September 20, 2003. Four timely responses were received. A source selection panel was convened and all four proposals were evaluated based on technical proposal, past performance and price. During the evaluation process, Northstar Consultants clarified why it did not include a Certified Public Accountant (CPA) in its offer and that it would provide a CPA in at least one review and otherwise, as required. The award was made based on overall best value.

Q4

Line 2100 | Ms. MALONEY. But my point and my question, if I could, Mr. Chairman, was directed a to the $400 million that Mr. Bowen says he can not have the resources to look at at this point. The other three

Line 2104 | Mr. SHAYS. I'd suggest to the gentlelady that she will have a second round to

Line 2106 | Ms. MALONEY. But the gentlemen say they are not looking at it. I am just saying that is a lot of money. Someone should be looking at it. I think it is an important program, but if there is a waste, fraud and abuse of these dollars, Mr. Bowen has already referred three people to the eastern district court system, and I think that the other $400 million should likewise be audited, and from their testimony no one is doing that now.

Line 2114 | Mr. SHAYS. Let me just clarify. Is no one doing it now? I am confused by that.

Line 2116 | Mr. BOWEN. We are auditing the CERP program and that it $600 million and that is nationwide. With respect to the R3P, I do not know if the other regions' allocations of R3P are being audited.

Line 2120 | Mr. SHAYS. Could you provide that information back to the committee?

Line 2122 | Mr. BOWEN. Yes, sir.

Response for the Record: SIGIR is not auditing the other three region's R3P programs. This is consistent with SIGIR's enabling legislation, PL 108-106, as amended, which focuses on auditing and investigating activity funded by the Iraq Relief and Reconstruction Fund and SIGIR's existing resources. We are unaware of any other activity auditing these regions.

Q5

Line 2436 | Mr. KUCINICH. ... According to information provided by staff, I am being told that this is $2 million in cash paid, according to Frank Willis, to Custer Battles. Again, according to Mr. Willis, the company was told to bring a big bag for payment. I offer this, Mr. Bowen, for your consideration as you begin to look at the manner in which things were disbursed and to whom. Custer Battles is a U.S. contractor. Mr. Bowen, do you know how many private contractors there are in Iraq right now? Do you have any idea?

Line 2446 | Mr. BOWEN. We have developed a database that is tracking who has received contracts in Iraq, so yes, we have that information.

Line 2449 | Mr. KUCINICH . Can you give the committee a number?

Line 2450 | Mr. BOWEN. I will have to provide that number for you. I do not want to ballpark it right now.

[NOTE: Based on information in the SIGIR Iraq Reconstruction Information System (SIRIS), there are 3,858 contractor organizations in Iraq with contracts for Iraq reconstruction. Of these, 2,775 are Iraqi, and 1,083 are non-Iraqi companies. However, the reliability of this data is not certain. We have found that the Army Material Command may have much more detailed information on the actual numbers of contractor personnel that are in Iraq. We expect to have this information by next week (August 29).]

○