

Testimony of

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“How Good Is Our System for Curbing Fraud, Waste, and Abuse?”

Before the
Commission on Wartime Contracting in Iraq and Afghanistan

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Co-Chairmen Thibault and Shays, and Commissioners, thank you for inviting us to present our views on the investigation and prosecution of contract fraud in stabilization and reconstruction operations (SROs). With me today is Jon Novak, SIGIR’s Assistant Inspector General for Investigations. As requested, we will address issues related to general controls over funds and contracting in Iraq, and the extent of fraud in Iraq reconstruction activities. We will also address resources and processes SIGIR uses to investigate allegations of fraud, specific cases that have been prosecuted, and actions we believe are needed to prevent and detect fraud in current and future SROs.

A Contracting Environment Highly Vulnerable to Fraud

It is important to note that the SRO contracting environment is much more vulnerable to fraud than contracting activities that are carried out in normal circumstances. SROs are complex programs posing unique challenges in oversight. SROs often involve myriad agencies and billions of U.S. dollars applied rapidly in an often chaotic and violent overseas environment. In the case of Iraq, more than \$50 billion was appropriated for reconstruction activities. These operations are further complicated by a lack of sufficient numbers of trained contracting and oversight personnel, lack of comprehensive program plans or established program offices, weak internal controls, and constantly changing requirements. Further, in the case of Iraq, many payments on contracts were made in cash, exacerbating the vulnerability to fraud and theft. As a result of this environment, U.S. taxpayer dollars are often highly susceptible to fraud, waste, and abuse.

This point was best captured in *Hard Lessons: The Iraq Reconstruction Experience*, where we noted that in the first year of the reconstruction experience in Iraq, weak or absent oversight permitted unscrupulous individuals to commit fraud and other crimes. This hard lesson underscores the need to ensure that future contingency operations include strong oversight from their outset so that U.S. taxpayers’ dollars are kept as safe as possible from criminal abuse, and that when crimes do occur, the perpetrators are caught and brought to justice. Although maintaining the proper balance between operational effectiveness and strong oversight will always be challenging in a contingency operation, ensuring a robust inspector general presence from an operation’s inception is essential and should never be overlooked. Therefore, a key point to keep in mind is that SROs create unique oversight challenges that require special and innovative techniques to prevent and detect fraudulent activities.

Extent of Fraud in Iraq Reconstruction Activities

While we have no basis for calculating the exact impact of undetected fraud on funds appropriated for reconstruction activities, we can say that our investigative work has identified a significant number of instances where fraud occurred in the contracting processes. As of May 2010, SIGIR's investigations have led to 42 indictments, 32 convictions, and \$72.4 million in fines, restitutions, and other monetary results. In addition, there exists one sealed indictment, one signed plea agreement, and at least 15 more draft indictments being prepared against other suspects at this time. Including cases with pending charges, we have more than 60 investigations where we expect judicial criminal action. Our caseload of 113 investigations is also steadily expanding, and the pool of subjects keeps growing.

The types of criminal activity and the programs looted vary. To date, SIGIR's investigators have uncovered bribery and kickbacks between contract officials and contractors; extortion by contracting officials; embezzlements; thefts of cash and equipment by officials and contractor employees; bribery of Iraqi officials; and fraud by U.S. and allied contractors. Moreover, officials of the Departments of Defense (DoD) and State (DoS), as well as of non-governmental organizations, have all been found to have been involved in criminal activity. Both senior and junior officers and enlisted personnel in the U.S. military—up to the rank of full colonel—have been convicted of reconstruction-related crimes. Military personnel from coalition partner countries have also been convicted, as have the owners and employees of contracting firms, and civilian employees of the U.S. government. While many of the weaknesses that contributed to a criminally susceptible environment have been addressed over the past six years (for example, more contracting officers have been added to DoD's acquisition corps), others have not.

SIGIR Investigative Resources and Processes

The SIGIR Investigations program began with a staff of 5 civilians and 3 contractors in 2004, increasing gradually to a total of 24 in fiscal year 2007. Currently, SIGIR's Investigations Directorate is staffed by 36 highly experienced professionals in the United States and Iraq who are closely matched to the specific investigative problems we encounter. Our investigators have expertise in conducting analyses of complex financial and business records, in tracing funds domestically and internationally, and in investigating contracting and complex white-collar fraud, to name a few. They understand the cultures of DoD and DoS and have experience working overseas and contacts with law enforcement personnel around the world. In addition to our experienced investigators, SIGIR has supplemented our staff with support personnel who speak and read Arabic, including former officials from DoD and DoS who have worked in Iraq for several years.

I want to highlight five key processes that enhanced SIGIR's investigative capabilities and results.

The first relates to the evolution of SIGIR's working relationship with the Department of Justice (DOJ) and other law enforcement agencies. Prior to 2007, SIGIR presented its Iraq-related fraud cases to the Criminal and Antitrust Divisions at DOJ. However, these divisions had, and still have, limited resources, given the dozens of investigative agencies in the federal government that they support. To obtain additional prosecution support, SIGIR began to take its cases to individual Assistant U.S. Attorneys in U.S. Attorney's Offices across the country. SIGIR also reached out to foreign law enforcement entities on prosecutions involving foreign subjects who had defrauded a U.S.-funded reconstruction program. SIGIR's agents then worked jointly with these foreign

agencies—and Iraqi authorities—assisting them in the prosecution of the subjects in their home countries.

The second is that we strategically co-located our investigators with other investigative organizations around the country where the heaviest workloads are found. We currently have nine field offices located in New York, Pennsylvania, North Carolina, Florida, Texas, Arizona, California, Michigan, and Ohio. This approach has proven to be highly successful in that we have been able to open and pursue cases in a much faster manner than when our staff was centrally located at SIGIR headquarters.

Third, we developed the SIGIR Prosecutorial Initiative, or SIGPRO. Beginning six months ago, SIGIR hired three highly experienced and respected former federal prosecutors and detailed them to the Criminal Division of the DOJ to work exclusively on cases in SIGIR's jurisdiction. This was accomplished through close collaboration with, and support from, senior DOJ officials. The SIGPRO attorneys work hand in hand with SIGIR's investigators on emerging cases to ensure that these cases are in the best posture for eventual successful prosecution. In addition to handling their own prosecutorial caseload, SIGPRO attorneys also work closely with Assistant U.S. Attorneys and other DOJ attorneys who are currently handling SIGIR matters, providing them with guidance that comes from a deep understanding of the unique field of contingency operations. The result is the vigorous prosecution of cases arising under SIGIR's jurisdiction, and the potential to create within the Department of Justice a new cell of expertise that will specialize in overseas contingency crimes—both criminal and civil.

Fourth, we also developed the FERRET program, which is short for the Forensic, Evaluation, Research, Recovery, and Enforcement Team. FERRET is a sensitive investigative program that utilizes investigative and audit techniques combining sophisticated data analysis combined with traditional investigative technique and coordination with other organizations such as the Financial Crimes Enforcement Network (FinCEN) within the Department of the Treasury. FINCEN supports SIGIR in its efforts to investigate financial crimes by providing access to financial data, analysis and case support. Tens of thousands of records are being reviewed in the context of the Iraq reconstruction program, an effort that has so far led to 45 open investigations involving 60 subjects.

Fifth, we implemented a forensic audit program in response to our mandate to forensically audit DoD, DoS, and U.S. Agency for International Development's Iraq reconstruction activity expenditures. The objectives of the forensic effort are to (1) identify indicators of fraud, waste, and abuse, (2) report on internal controls weaknesses, and (3) produce leads for criminal investigations. Using data-mining techniques, SIGIR is in the process of analyzing more than \$40 billion in transaction data associated with Iraq reconstruction activities.

Selected Prosecutions Resulting from SIGIR Investigations

The following are several examples of cases resulting from SIGIR investigations that have been successfully prosecuted.

- The “Bloom-Stein” conspiracy, centered in Al-Hillah, Iraq, began with a whistleblower complaining to SIGIR about contracting irregularities. SIGIR auditors looked into the allegations, finding that contract awards to a particular U.S. contractor involved inflated charges, the circumvention of CPA regulations, improper disbursements, inferior work, and

work not performed. The resultant SIGIR investigation uncovered a scheme where millions of dollars were stolen from the CPA and more than a million dollars in cash, expensive vehicles, computers, jewelry, promises of employment, and other items of value were given by the contractor to numerous CPA contracting officials. The contractor also laundered in excess of \$2 million in cash from the Development Fund for Iraq that had been stolen from a CPA vault. In the end, the contractor and seven other individuals were convicted, including a full colonel, the second most-senior CPA official in the South Central Region, and three lieutenant colonels, one of whom was the Acting Comptroller for the CPA in the region.

- In one investigation in which we worked closely with representatives of the South Korean government, SIGIR found that South Korean military contracting personnel operating in northern Iraq were extorting payments from Iraqi contractors and inflating construction costs. These South Korean military personnel were responsible for administering U.S. Commander's Emergency Response Program and South Korean construction funds, but had minimal oversight by U.S. authorities. In fact, U.S. authorities had a difficult time obtaining access to their U.S.-funded construction sites. In this case, SIGIR brought in and worked with investigators from the South Korean Ministry of Defense and was provided substantial support by the U.S. Army Criminal Investigation Command. Ultimately, two South Korean Army officers and an enlisted soldier were convicted in South Korea and sent to prison.
- SIGIR investigators have also formed strong ties with investigators from the United Kingdom. One case involves a British contractor and a related U.S. firm who were paid \$8.5 million in Iraqi funds to provide armored vehicles for Iraqi Security Forces. The investigation found that the money was released by a U.S. bank to the British contractor after the contractor provided a false bill of lading to the bank. The bill of lading fraudulently represented that the vehicles had been received by the shipper and were in transit to Iraq when, in fact, no vehicles had been shipped. The U.S. contract official in Baghdad was never made aware of the request for payment, nor that the payment had ever been made. The U.S. contracting official terminated the contract after finding out the vehicles were not going to be delivered. To date, one American has pled guilty, two British nationals have been charged in England, and a third British subject has been arrested.
- In an example of a collaborative investigative effort within the U.S. government, SIGIR agents joined a multi-agency task force with the Army Criminal Investigation Command, the Defense Criminal Investigative Service, the Internal Revenue Service, the Naval Criminal Investigative Service, Immigration and Customs Enforcement, and the Federal Bureau of Investigation, that uncovered a wide-ranging bribery scheme involving contracts funded by Iraq Relief and Reconstruction Fund, the Iraq Security Forces Fund, and the Army Operations and Maintenance Fund. The investigation found that millions of dollars in bribes were paid to military and civilian contracting officers in return for awarding contracts to specific contractors. The investigation has involved contracts dating back to 2004—specifically, a CPA contract valued at more than \$12 million annually to build and operate a series of warehouses in Iraq. A senior member of the selection board for the contract accepted gifts in exchange for his assistance to the winning bidder. To date, the efforts of the task force have resulted in the indictment of 13 individuals, with 11 convictions and fines, forfeitures, and recoveries of more than \$37.6 million.

Actions To Prevent and Detect Fraud in Current and Future SROs

SIGIR believes the following key conditions must be met to achieve effective oversight in SROs:

- Investigative capability has to be present from the outset of the SRO.
- Investigative personnel need to be present in the country where the SRO is occurring.
- Investigative personnel must be experienced investigators and knowledgeable about the types of programs, activities, and cultures of agencies that they are investigating.
- Investigative resources must be allocated to where the heaviest prosecutorial workloads are located.
- Collaborative working relationships with other law enforcement agencies, both domestic and international, must be established at the outset of the SRO.
- Collaborative working relationships must be established between investigative and auditing activities to maximize the utilization of evidence that is being gathered related to ongoing investigations to include the use of data mining and other forensic techniques as appropriate.
- Robust legal support and prosecutorial capacity and capability must be developed to facilitate the expeditious prosecution of cases. Innovative approaches such as the SIGPRO initiative should be utilized as necessary.

In summary, investigative oversight in SROs represents a special set of challenges. To meet those challenges, inspectors general need a special set of tools. I trust my remarks have set forth a number of special tools that must be present to have a successful capability and capacity during an SRO. Thank you for your attention, and we are happy to answer any questions you may have.