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BEFORE THE

**UNITED STATES HOUSE
COMMITTEE ON INTERNATIONAL RELATIONS**

REVIEW OF IRAQ RECONSTRUCTION

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Introduction

Mr. Chairman, Ranking Member Lantos, 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. The Congress has tasked my office, the Special Inspector General for Iraq Reconstruction (SIGIR), to provide oversight of this substantial and challenging endeavor. I am here today to provide you with the most current reporting on SIGIR's oversight efforts in Iraq. I hope for a productive exchange of views and ideas in this hearing regarding Iraq reconstruction.

A few days after submitting our April 30, 2006 Quarterly Report to Congress, I returned to Iraq for my 12th tour, to work in Baghdad and across Iraq with SIGIR's 50 staff members currently stationed in Baghdad. I also had numerous meetings with those managing the operational and contracting components of the US reconstruction effort in Iraq. I returned from Iraq a week ago and I am pleased to provide you my observations garnered from my recent weeks of work in Iraq. I also want to update you on the critical issues raised in SIGIR's April 30, 2006 Quarterly Report to Congress.

As SIGIR noted in its January 2006 Quarterly Report, this is the Year of Transition in Iraq reconstruction. By the end of 2006, most programs and projects funded by the IRRF will be turned over to Iraqi authorities. With that prospect on the horizon, reconstruction planning and operations are increasingly becoming a joint enterprise, with U.S. and Iraqi officials coordinating more and more on the planning of key reconstruction initiatives.

With approximately 67% of the \$18.4 billion in Iraq Relief and Reconstruction Funds (IRRF) now expended and just under \$2 billion left to obligate, the U.S. reconstruction program in Iraq is fully engaged in project execution and sustainment, contract close-out, and program transition. Effectively advancing the progress of reconstruction and development in Iraq at this critical juncture requires the U.S. government to work closely with the Iraqi government and international donors to sustain the substantial U.S. investment in Iraq's infrastructure.

In its April 2006 Quarterly Report, SIGIR identified five critical issues confronting the reconstruction program at this watershed moment in the Iraq endeavor:

- **Improve Infrastructure Security:** critical nodes must be protected
- **Close the Reconstruction Gap:** fund the Secretary of State's initiative to build capacity at the local level
- **Energize the Oil and Gas Industry:** 94% of Iraq's national income is derived from this industry but only 9% of the IRRF was spent on it

- **Fight Corruption:** Iraq continues to lose capital to widespread corrupt practices
- **Engage the Donor Community:** the reconstruction program must be multilateralized

Improve Infrastructure Security – SIGIR continues to review the critical issue of infrastructure security. Insurgent activity impedes ongoing reconstruction projects and interrupts the transition of these projects to Iraqi control. Attacks on Iraq’s oil and gas and electrical infrastructures have limited progress in the past within these key sectors. Early U.S. efforts to address this issue did not succeed as SIGIR auditors discovered in a review of a \$147 million program called Task Force Shield, which was established in September 2003 to build Iraq’s capacity to protect its oil and gas and electrical infrastructure. Task Force Shield sought to cover 340 key installations, 7,000 kilometers of oil pipeline, and 14,000 kilometers of electrical transmission lines. The audit found that the program failed to meet its goals.

SIGIR is now executing a significant current review of this issue and will provide a classified report on it during this quarter. I addressed the infrastructure security issue with U.S. leadership in Baghdad during my recent trip to Iraq. Recognizing its importance, the U.S. Ambassador to Iraq has made infrastructure security an essential element of the Embassy Joint Blueprint for Success. Of note, significant progress has been made on infrastructure security over the past quarter. For example, the Department of Defense dispatched a team of experts to Iraq last quarter to assess the protection of oil and gas facilities. They examined the sector’s infrastructure protection programs, seeking to identify current security challenges. The team is now drafting a strategy that will help the Iraqis more effectively protect their energy infrastructure.

Close the Reconstruction Gap – SIGIR’s October 2005 Quarterly Report identified a “reconstruction gap,” which acknowledged that—for a variety of reasons, security being the most salient—the U.S. relief and reconstruction program will accomplish less than originally planned. The shortfall in various sectors was caused by more than 250 reprogramming actions, delays driven by security and administrative problems, poorly managed cost-to-complete schedules, and shifting emphases in contracting and program management. Of note, another reprogramming of the IRRF occurred this quarter: \$353 million was shifted from the electricity and health care construction sectors into non-construction programs. The reconstruction gap, however, comprises more than simply the notion that fewer projects will be completed than expected; it also addresses the shortfall’s impact on outputs and outcomes.

Fewer projects completed axiomatically affects infrastructure outputs in Iraq—that is, fewer electrical projects means fewer megawatts on the grid, and fewer oil and gas projects means fewer barrels of oil produced per day. These constrictions have the cumulative effect of slowing improvement in the daily lives of Iraqis.

Ambassador Khalilzad’s initiative to devolve more project decision-making to Iraqis at the local governorate level should help remediate the perceived effects of the reconstruction gap by giving Iraqis more of a say in reconstruction priorities that can be implemented close to home. Iraqis are now exerting a formative influence over project choices. Their management of the process through the Provincial Reconstruction Development Councils, assisted by coalition-staffed Provincial Reconstruction Teams, is building local government capacity in Iraq. The aim of the Ambassador’s initiative is to produce more immediate, perceptible benefits for Iraqis in every governorate. The success of the Ambassador’s initiative depends, in part, on new funding. Thus, SIGIR strongly supports the President’s FY 2006 supplemental and FY 2007 budget requests, which propose an additional \$3.2 billion to help secure and sustain Iraq’s critical infrastructure, to build the capacities of

national and local governments, and to stimulate economic growth, increased employment, and private-sector development.

Energize the Oil and Gas Industry – Iraq has the second-largest oil and gas deposits in the world, with revenue from this sector providing 94% of Iraq’s national income. Several factors, however, have limited progress in the oil and gas sector: breakdowns in the sector’s deteriorated infrastructure, delays in forming the new Iraqi government, uncertainties regarding the legal framework governing Iraq’s petroleum industry, and attacks on the sector’s critical nodes.

Despite U.S. allocations of \$1.7 billion (9% of IRRF II) and supplemental Iraqi expenditures, the sector is struggling to return to pre-war oil production levels. Consequently, Iraq’s national income has yet to achieve its great potential, which will be necessary if the country is to fully shoulder its primary role in recovery and reconstruction. Before the war, three assumptions were made about the oil and gas sector in Iraq:

- that oil and gas revenues in post-war Iraq would pay for much of the reconstruction
- that foreign private investment in the oil and gas sector would quickly flow into Iraq after the fall of the Saddam regime
- that post-war Iraq would be sufficiently secure to allow the development of oil and gas without hostile impediment.

To varying degrees, each of these assumptions has proved to be incorrect. Attacks on the oil infrastructure and a dilapidated system have slowed production and reduced potential revenue. Moreover, outside investors have been unwilling to commit capital to this sector until the insurgency abates and a permanent government takes power and articulates the rules of the game. Accordingly, the new Iraqi government, which is now forming, can provide necessary certainty by quickly drafting, approving and implementing laws that govern foreign investment in the oil and gas sector.

Fight Corruption – Corruption is another form of insurgency in Iraq. This second insurgency can be defeated only through the development of democratic values and systems, including the evolution of effective anticorruption institutions in Iraq. The primary players in this effort are the Commission on Public Integrity, the Board of Supreme Audit, and the 29 inspectors general in the Iraqi ministries.

SIGIR worked at generating support for these institutions early on and continues to highlight the need to support them financially. Iraq, the United States, and other donors should sustain and increase funding for these essential institutions. New funding will bolster their effectiveness, while raising general awareness of the new Iraqi government’s commitment to fighting corruption. Better anti-corruption practices would help improve the overall investment climate.

SIGIR previously reported that the Department of State developed an initiative to strengthen anticorruption efforts in Iraq. Now, at the request of U.S. Embassy-Baghdad, SIGIR and the DoS Office of Inspector General are finishing up a coordinated survey of the \$365 million supporting U.S. anticorruption programs in Iraq. The survey is intended to assess the initiatives and establish metrics to gauge progress. The next step should be to coordinate further with other donors on anti-corruption activities.

Engage the International Donor Community – As the year of transition in Iraq unfolds and IRRF funds concomitantly draw down, the role of international donor nations will become increasingly

important. The next phase of Iraq's reconstruction will require a broader international effort. U.S. reconstruction officials should begin now to engage more directly and intensively with their international counterparts—the World Bank, in particular—to help ensure that donors implement pledges and develop, in close coordination with the Iraqis, the way forward for the next phase of reconstruction.

Funding is particularly needed to stimulate the oil and gas sector, which has thus far underperformed for a variety of reasons (noted above). SIGIR applauds the promising development of an integrated donor database to aid coordinating and de-conflicting donor activities, but the system needs more comprehensive inputs from all donors before it can become an effective management tool.

SIGIR is now in its third year of providing oversight for reconstruction and relief in Iraq, detecting and preventing waste, fraud and abuse in the lethal operating environment that is Iraq today. Moreover, we continually seek to help improve the controls, processes and accountability measures of those managing Iraq reconstruction. I instruct every SIGIR auditor and inspector to focus on achieving real-time real time results by reporting problems immediately upon their discovery, which allows for improved operational guidance within the reconstruction program. We do not wait for our reports to be released to apprise those concerned of our concerns.

This philosophy diverges from traditional IG oversight mechanisms, but it is essential in Iraq because there is no time for lengthy critiques. Thus, along with its oversight role, SIGIR also performs a consultative role, seeking to achieve real, money-saving results by applying relief and reconstruction lessons learned in real time.

In Iraq, SIGIR staff works side-by-side with the leaders of the reconstruction program: Ambassador Zalmay Khalilzad; General George Casey, Commander, Multi-National Force, Iraq; Ambassador Dan Speckhard, the Director of the Iraq Reconstruction Management Office; Major General Bill McCoy, who is about to complete his tour as Commanding General, Gulf Regional Division, U.S. Army Corps of Engineers; Major General Darryl Scott, Commander, Joint Contracting Command-Iraq/Afghanistan; and Ms. Dawn Liberi, the USAID Mission Director.

In the course of performing our oversight functions during this reporting period, we found that the U.S. Ambassador to Iraq, the Commander of the U.S. Army Corps of Engineers Gulf Region Division, and the Mission Director of the U.S. Agency for International Development have continued to improve management coordination of the Iraq reconstruction program.

To facilitate coordination and collaboration among U.S. oversight bodies covering Iraq, SIGIR created and chairs the Iraq Inspectors General Council, to ensure that all oversight organizations keep one another informed of current and planned work on overseeing Iraq reconstruction programs.

The April 30, 2006, SIGIR Quarterly Report to Congress provides SIGIR's latest series of new audit and inspection reports, which, taken together, detail the current challenges, issues and concerns confronting the Iraq reconstruction effort.

More specifically, SIGIR issued 29 audits and inspections this quarter, which contain 58 new recommendations. Although these audits and inspections raise a variety of concerns, SIGIR generally found many instances of effective reconstruction projects and the overall picture, though mixed, nevertheless conveys a sense of gradual progress. SIGIR concluded that the likelihood of a project's

success was high if quality control had been integrated actively into the project's management and if government oversight was consistent and disciplined.

SIGIR's audit work this quarter included a performance review of the contract to construct primary health care centers, an audit of reconstruction management information systems, and an examination of the planning and processes for transferring reconstruction assets to the new Iraqi government. The primary health care center report presents a difficult story.

Our comprehensive look found shortfalls: only 6 of 150 clinics have been completed, although 75% of the funding had been spent. In addition, 14 more clinics are being completed under the original contract, each with construction issues yet to be resolved. The Iraq Reconstruction Management Office estimates that approximately \$36 million will be required to complete 121 partially constructed clinics that were terminated for convenience.

The 13 inspections completed this quarter continued SIGIR's mission to provide on-site assessments of projects in every sector across Iraq. Most of the projects reviewed are still in progress; thus, SIGIR's recommendations allow for money-saving course-corrections. SIGIR also inspected 55 additional projects through its rapid-review program, using local hires to visit sites that SIGIR inspectors cannot reach.

Overall, SIGIR inspectors found that, where management and quality assurance programs were active in the on-site construction process, the quality of work usually met or exceeded contract standards. Moreover, we believe that the expansive coverage of its inspections teams provides a highly visible deterrent to those who might be inclined to commit acts of fraud, waste, and abuse.

SIGIR criminal investigators are currently working on 72 open cases involving fraud, theft, bribery, and other alleged crimes. As outlined in our quarterly report, contractor Philip Bloom and former Coalition Provisional Authority (CPA) regional comptroller Robert Stein pleaded guilty to conspiracy, bribery, and money laundering in connection with a scheme to defraud the CPA.

Bloom now faces up to 40 years in prison and a fine of \$750,000. Under the terms of his plea agreement, he must pay \$3.6 million in restitution and forfeit \$3.6 million in assets. Bloom admitted that from December 2003 through December 2005, he, Stein (who faces 30 years in prison), and other officials conspired to rig bids to ensure that the contracts were awarded to Bloom. The total value of the contracts exceeded \$8.6 million. Bloom admitted paying Stein and other public officials more than \$2 million in bribes.

Earlier this year, SIGIR investigators conducted a sting operation involving an alleged criminal conspiracy. The sting resulted in the arrest of a contractor who offered a bribe to a SIGIR undercover agent. The case is currently being managed by the U.S. Department of Justice.

During this quarter, the third forum of SIGIR's Lessons Learned Initiative was conducted, focusing on program and project management in Iraq reconstruction. It brought a number of the leading experts on Iraq reconstruction together for a day-long review of the research that SIGIR had compiled on this critical issue. In the next few weeks, SIGIR will release its second Lessons Learned report, addressing contracting in Iraq reconstruction. The report examines the establishment and evolution of the contracting policies, procedures, and systems used by U.S. government agencies to address the challenges associated with strategy and planning, policies and processes, and staffing during the U.S.

reconstruction effort in Iraq. This report is the result of extensive research and a formal, collaborative process involving a panel of experts from inside and outside government. Our recommendations include:

- Creating a Contingency Federal Acquisition Regulation
- Institutionalizing special contracting programs for federal agencies
- Including contracting staff from the beginning of any reconstruction effort's pre-deployment planning process
- Creating a ready-to-deploy reserve corps of contracting personnel who are trained to execute relief and reconstruction contracting for contingency operations
- Developing a system for formulating better contracting and procurement requirements in contingency operations
- Pre-competing and pre-qualifying a diverse pool of contractors with expertise in specialized reconstruction areas

The program and project management report will be released in late summer of 2006. It will examine the issues associated with initiating, planning, executing, controlling, and closing/hand-off of the Iraq reconstruction program. The report will examine a variety of execution challenges within the key project management issues: scope, time, cost, quality, people, communication, risk, and procurement (subcontractors).

SIGIR's first Lessons Learned report, which examined human capital management, was released in January. SIGIR will release a comprehensive capping report on all of our lessons learned in the Iraq reconstruction process during the first quarter of 2007.

As SIGIR looks to its next Quarterly Report, it is working on audits and inspections that address developing critical issues. For example, SIGIR is now conducting a review of ministry capacity building efforts. Iraq's new government is now re-staffing the 28 ministries responsible for managing government operations. For transition to succeed, Iraq must ensure that its ministries are ready to receive and capably manage completed projects. U.S. transition plans anticipate this structural development to occur within Iraq's government this year. SIGIR's review will provide an update on this issue.

In conclusion, let me say that SIGIR remains committed to supporting the reconstruction efforts in Iraq by identifying ways to accomplish the mission more effectively and efficiently, and by deterring fraud waste and abuse of US taxpayer dollars. SIGIR's 55 auditors, inspectors and investigators will continue to carry out the duties and responsibilities assigned by the Congress in the highly hazardous environment that is Iraq today.

I remain proud of my staff's commitment and willingness to serve in harm's way, far from their families, and in very fluid circumstances. I will continue to do my best to ensure effective oversight and timely reporting, and to thereby advance the success of the Iraq reconstruction plan. Thank you for the opportunity to participate in this important hearing, and I look forward to answering any questions that the Committee may have.