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ACQUISITION UNDER DURESS: RECONSTRUCTION CONTRACTING IN IRAQ

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

SEPTEMBER 28, 2006

Serial No. 109–192

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

30–592 PDF WASHINGTON : 2006

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ACQUISITION UNDER DURESS: RECONSTRUCTION CONTRACTING IN IRAQ

THURSDAY, SEPTEMBER 28, 2006

HOUSE OF REPRESENTATIVES,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Tom Davis (chairman of the committee) presiding.

Present: Representatives Tom Davis, Clay, Cummings, Dent, Duncan, Foxx, Gutknecht, Kucinich, Lantos, Maloney, McHugh, Norton, Porter, Shays, Van Hollen, Watson, and Waxman.

Staff present: David Marin, staff director; Larry Halloran, deputy staff director; Keith Ausbrook, chief counsel; Ellen Brown, legislative director and senior policy counsel; Mason Alinger, deputy legislative director; Patrick Lyden, parliamentarian; Edward Kidd, professional staff member; John Brosnan, procurement counsel; Paul Sherry, detailee; Benjamin Chance, clerk; Phil Barnett, minority staff director/chief counsel; Karen Lightfoot, minority communications director/senior policy advisor; Jeff Baran and Margaret Daum, minority counsels; David Rapallo, minority chief investigative counsel; Shaun Garrison, minority professional staff member; Earley Green, minority chief clerk; and Jean Gosa, minority assistant clerk.

Chairman TOM DAVIS. The committee will come to order.

Good morning, we meet today to look into the challenges surrounding the daunting task of coordinating and executing contracts to rebuild long-neglected critical infrastructure in war-torn Iraq. Since 2004, the committee has been engaged in continuous and vigorous oversight of contracting activities in Iraq. The oversight has involved four hearings on the challenges of contracting in a war zone, numerous briefings from the agencies involved in the contracting efforts, as well as a review of thousands of documents the committee obtained from key Federal agencies.

Those efforts focused primarily on contracts for logistical support of U.S. military operations. In this hearing, we will examine the process, the progress and the problems of reconstruction contracting activities in Iraq.

Since the beginning, it has been our goal to move beyond the polarized politics that swirl around any topic related to the war in Iraq and conduct thorough, balanced oversight of acquisition activities there. Some have not shared that goal, choosing instead to play hit and run oversight with inflammatory press releases and one-sided presentations from self-appointed watchdogs and whistle-

blowers. I think they oversimplified the story and pre-judged the outcome of complex contracting processes to fit the preordained conclusion that everything goes wrong in Iraq. And they will never let it go without saying it is all Halliburton's fault.

I hope this hearing will be different. We will hear from the administration, from two of the most active oversight offices, and from participating contracting firms. I know that means we have a larger number of witnesses and that this hearing will take some time to complete. But real oversight, responsible oversight is as much a matter of due diligence as startling disclosures. It should be about sustaining good government, not the quick "gotcha."

The picture painted by our witnesses today will not be pretty, nor will their testimony necessarily tell the complete story of an evolving, dynamic, sometimes dangerous process. But this much is clear: poor security, an arcane, ill-suited management structure, and a dizzying cascade of setbacks have produced a succession of troubled acquisitions.

The construction of a children's hospital in Basrah is almost a full year behind schedule and more than $50 million over budget. A project for the construction of 150 primary health care centers across Iraq has consumed over $180 million but has resulted in the completion of only six centers At best, the Iraqis will end up with only 20 of the health facilities planned under this contract. Other troubled projects include a $218 million emergency communications network that does not allow citizens to call for emergency services and multiple water projects that are chronically over budget and behind schedule.

Just this morning, we learned the details of yet another critical reconstruction project gone terribly wrong, a $75 million police academy that has been so poorly constructed that it poses health risks to its occupants and may need to be partially demolished.

Obviously, security is the critical factor driving cost and confounding contract management and oversight. On a daily basis, our military, civilians and contractors come under hostile fire. A number of contractor employees have been killed or wounded. It is a major understatement to say Iraq is a tough place to conduct business. Travel can be difficult or impossible. So it is no surprise that normal acquisition support and oversight resources are stretched to the breaking point.

But a challenging security environment cannot excuse otherwise avoidable problems and preventable waste. Original plans proved wildly optimistic. Only about 55 percent of the planned water projects and about 70 percent of the planned projects in the electricity sector have been completed. According to the Special Inspector General for Iraq Reconstruction, we keep spending more and building less because cost estimates are still inaccurate, reconstruction priorities and funding allocations keep shifting, and contractor performance is not being closely monitored.

So we need to learn how contracting systems designed to work here are being adapted to function under very different, hostile circumstances over there. We have to ask whether contractors have over-promised and under-performed or whether the companies were stuck in an environment where success was virtually impossible. But things have been built, and some of our witnesses today

will testify that, despite many challenges, we are progressing, slowly but surely. In fact, the Special Inspector General points out that his onsite assessments show that about 80 percent of the projects inspected have met contract specifications.

Many of our witnesses have spent considerable time working in Iraq, and we value their experience and their perspective on the important issues raised by reconstruction contracts there. Much is at stake, in terms of U.S. tax dollars and in terms of effectively helping the Iraq people rebuild the basic infrastructure of their nation. We look forward to their testimony and to a frank, constructive discussion.

I now recognize our distinguished ranking member, Mr. Waxman, for his opening statement.

[The prepared statement of Chairman Tom Davis follows:]

Opening Statement of Chairman Tom Davis
Government Reform Committee Hearing
"Acquisition Under Duress: Reconstruction Contracting in Iraq"
September 28, 2006, 10:00 a.m.

Good morning. We meet today to look into the challenges surrounding the daunting task of coordinating and executing contracts to rebuild long-neglected critical infrastructure in war-torn Iraq.

Since 2004, the Committee has been engaged in continuous and vigorous oversight of contracting activities in Iraq. The oversight has involved four hearings on the challenges of contracting in a war zone, numerous briefings from the agencies involved in the contracting efforts as well as review of thousands of documents the Committee obtained from key federal agencies. Those efforts focused primarily on contracts for logistical support of U.S. military operations. In this hearing, we will examine the process, the progress and the problems of reconstruction contracting activities in Iraq.

Since the beginning, it has been our goal to move beyond the polarized politics that swirl around any topic related to the war in Iraq and conduct thorough, balanced oversight of acquisition activities there. Some on the other side have not shared that goal, choosing instead to play "hit and run" oversight with inflammatory press releases and one-sided presentations from self-appointed watchdogs and whistleblowers. They oversimplify, distort and prejudge the outcome of complex contracting processes to fit the pre-ordained conclusion that everything goes wrong in Iraq. And, they never let it go without saying it's all Haliburton's fault.

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The picture painted by our witnesses today will not be pretty, nor will their testimony necessarily tell the complete story of an evolving, dynamic sometimes dangerous process. But this much is clear: Poor security, an arcane, ill-suited management structure, and a dizzying cascade of set-backs have produced a succession of troubled acquisitions.

The construction of a children's hospital in Basrah is almost a full year behind schedule and more than $50 million over budget. A project for the construction of 150 primary healthcare centers across Iraq has consumed over $180 million but has resulted in the completion of only six centers. At best, the Iraqis will end up with only 20 of the health facilities planned under this contract. Other troubled projects include a $218 million emergency communications network that does not allow citizens to call for emergency services and multiple water projects that are chronically over budget and behind schedule.

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Obviously, security is the critical factor driving costs and confounding contract management and oversight. On a daily basis, our military, civilians, and contractors come under hostile fire. A number of contractor employees have been killed or wounded. It is a major understatement to say Iraq is a tough place to conduct business. Travel can be difficult or impossible. So it is no surprise that normal acquisition support and oversight resources are stretched to the breaking point.

But a challenging security environment cannot excuse otherwise avoidable problems and preventable waste. Original plans proved wildly optimistic. Only about 55% of the planned water projects and about 70% of the planned projects in the electricity sector have been completed. According to the Special Inspector General for Iraq Reconstruction, we keep spending more and building less because cost estimates are still inaccurate, reconstruction priorities and funding allocations keep shifting, and contractor performance is not being closely monitored.

So we need to learn how contracting systems designed to work here are being adapted to function under very different, hostile circumstances over there. We have to ask whether contractors have over promised and underperformed or whether the companies were stuck in an environment where success was virtually impossible. But things have been built, and some of our witnesses today will testify that, despite many challenges, we are progressing – slowly but surely. In fact, the Special Inspector General points out that his on-site assessments show that about 80% of the projects inspected have met contract specifications.

Many of our witnesses have spent considerable time working in Iraq, and we value their experience and their perspective on the important issues raised by reconstruction contracts there. Much is at stake, in terms of U.S. tax dollars and in terms of effectively helping the Iraqi people rebuild the basic infrastructure of their nation. We look forward to their testimony and to a frank, constructive discussion.

Mr. WAXMAN. Thank you, Mr. Chairman, for holding this hearing. It is critical as part of our constitutional oversight responsibilities to have the Government agencies and private contractors involved in Iraq reconstruction work come before our committee to explain how U.S. taxpayer dollars are being spent.

This is the first full committee hearing on Iraq during this Congress. I wish we didn't have to wait until the last week of the session for it, but I am glad the chairman has called it.

I think most Americans understand that the reconstruction effort is failing. Today, we have a new symbol of the Bush administration's failure: the dilapidated and disgusting facilities at the Baghdad Police College, which the Army and the Parsons Co. spent $75 million to build.

A report today from Stuart Bowen, the Special Inspector General for Iraq Reconstruction, describes how the contractor's work and the administration's oversight were so grossly deficient that urine and fecal matter were literally raining down on Iraqi police recruits.

Let me read some of the direct quotes from the report: "Toilets are continually draining through the reinforced concrete floors, from the top floor to the second floor to the ground floor, permeating and filling light fixtures, showers and toilet areas, with liquids, including diluted urine and fecal matter."

"The urine was so pervasive that it had permanently stained the ceiling tiles."

Auditors "witnessed a light fixture so full of diluted urine and feces that it would not operate."

"The amount of material was so pervasive that it has soaked through the reinforced concrete floors, causing deterioration of the reinforced steel."

This debacle is not just a waste of taxpayer funds, and it doesn't just impact the reconstruction. It impedes the entire effort in Iraq. Not only will the number of basic recruits graduating through the facility be impacted, but more than that, this is the lens through which the Iraqis will now see America, incompetence, profiteering, arrogance, and human waste oozing out of ceilings as a result.

A new and disturbing poll found that 60 percent of Iraqis actually approve of attacks against U.S. forces and want us out of their country. Can there be any more obvious indication of failure?

By no means, however, is this the only example. The administration has spent over $30 billion in taxpayer funds and another $20 billion in Iraqi funds under its control, yet it has produced little of lasting value.

In the oil sector, the administration has spent over $2 billion. As of July, however, they were producing only 2.5 million barrels per day, still below prewar levels.

In the electricity sector, the administration has spent $4 billion. Yet electricity generation in August was just 4,900 megawatts, well below the administration's goal of 6,000 megawatts.

In the health sector, Bechtel was removed from the contract to rebuild the Basrah Children's Hospital because of massive cost overruns and schedule delays. And the Parsons Co., the same company in charge of the horrible Baghdad Police College, was termi-

nated after it finished only 6 of the 142 health clinics it was scheduled to build.

At the same time, the American taxpayer is facing record overcharges. Just this week, the nonpartisan Government Accountability Office, which is also here today, issued a report documenting that the Pentagon's own auditors have now identified an enormous sum, $3.5 billion, in questioned and unsupported charges under Iraq reconstruction contracts.

That amount, $3.5 billion, is what we spent on the entire reconstruction of Afghanistan. When we break down this amount, it averages $2.7 million in overcharges each day we have been in Iraq. That is amazing.

While there may be many reasons for this failure, there is no sense mincing words about the primary reason: the utter incompetence of this administration and its stubborn refusal to heed the warnings and advice of experts.

Last week, the Baghdad bureau chief for the Washington Post published a book documenting overt cronyism in hiring for key positions at the Coalition Provisional Authority, which is the governing body of the Bush administration created to run Iraq. The claims in this book were not made by anonymous, disgruntled employees. They were made on the record for attribution by some of the highest ranking officials at the CPA.

One of the most noteworthy is Frederick Smith. He was the Deputy Director of the CPA in Washington. He revealed that the criterion for sending people to Iraq was that they had the right political credentials, not their substantive expertise. He said the ideal candidate, from the administration's perspective, was not someone who spoke Arabic or had a development background, but someone who worked on the Republican side of the Florida recount in 2000. According to Mr. Smith, we "just didn't tap the right people to do this job. I just don't think we sent our A-team."

But the fact remains that incompetence results in failure. And in this case, incompetent decisionmaking at the highest levels of the CPA undermined the reconstruction, squandered billions of taxpayer dollars, endangered our troops, and contributed to the massive discontent and violence occurring in Iraq.

The recent revelations in the declassified National Intelligence Estimate underscore this assessment. The Intelligence Estimate says the jihadists "are increasing in both number and geographic dispersion," and that "if this trend continues, threats to U.S. interests at home and abroad will become more diverse, leading to increasing attacks worldwide."

Those are sobering words, and they are not used by accident. The intelligence community explicitly warns that there is a trend, and this trend is getting worse. The President is wrong when he says his strategy is winning the war on terror.

We have to face reality. Staying the course is strengthening our enemies and putting our security in jeopardy. The administration's entire Iraq policy is a failure. For the safety of our troops, for the sake of the taxpayer, and for our own security, the Nation urgently needs a fundamentally new direction.

Thank you, Mr. Chairman.

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

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INDEPENDENT

Opening Statement of Rep. Henry A. Waxman, Ranking Minority Member,
Committee on Government Reform Hearing on
"Acquisition Under Duress: Reconstruction Contracting in Iraq"
September 28, 2006

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We have to face reality. Staying the course is strengthening our enemies and putting our security in jeopardy. The Administration's entire Iraq policy is a failure.

For the safety of our troops, for the sake of the taxpayer, and for our own security, the nation urgently needs a fundamentally new direction.

Chairman TOM DAVIS. Thank you, Mr. Waxman.

Do any Members wish to make opening statements? Mr. Lantos. Mr. Duncan. I am sorry, and then Mr. Lantos.

Mr. DUNCAN. Thank you very much, Mr. Chairman. This is an important hearing and I understand it is the seventh hearing that this committee has held about Iraq. I have seen two recent articles, one from a couple of days ago which says a review of Iraq reconstruction funding revealed the 96 contracts worth $362 million were obligated for payment to dummy vendors, as opposed to legitimate suppliers. I think we need to know about that.

I have followed the Congress closely for more than 40 years, and I have never heard of anything such as that. I am pleased that Mr. Bowen is here to hopefully explain that to us, and what happened to that money.

Then last month, the Wall Street Journal had an article that said the corruption that has plagued Iraq's reconstruction, described by U.S. officials as a second insurgency, is worsening, complicating American reconstruction efforts and shattering public confidence in the Baghdad government, according to a new report by a Bush administration watch-dog agency. That also is for Mr. Bowen, but it said that in his quarterly audit, the Iraqi government estimates the corruption costs the country at least $4 billion a year, a staggering sum for a war-ravaged country that remains heavily dependent on foreign aid.

It sounds as though much of this corruption is by the Iraqi people themselves. As I drove in this morning, I heard on the all-news WTOP Station, they were having people call in about a recent poll that said 75 percent of the Iraqi people want us to leave Iraq. I know that people at the top of the Iraqi government want us to stay because this is a country that just before the war started, Newsweek magazine said had a gross domestic product of $65 billion total for the year before the war. So obviously they want our money. I saw in one of the congressional publications yesterday that we have now spent $463 billion since the start in both Iraq and Afghanistan, mostly in Iraq.

But we need to ask questions about these dummy contractors and about this corruption in Iraq. And also, I guess the key question here is, how much of these problems were caused by the contractors, but how much was caused by Iraqi corruption itself; and also by mismanagement by the military; also by military change orders; also how much was caused by just the war and the fighting itself.

So I think this is a very important hearing. I think the conservative Republicans have traditionally been the ones most concerned about waste, fraud and abuse within our Government. I am pleased that you would call this hearing and continue this series.

Thank you very much.

Chairman TOM DAVIS. Thank you, Mr. Duncan.

Mr. Lantos.

Mr. LANTOS. Thank you very much, Mr. Chairman.

You and my friend, Mr. Waxman, have raised many of the specific issues that concern all of us. I would like to take a different tack. But first let me commend Mr. Bowen for the invaluable work you have done on behalf of the American people. If it were not for

your inspector general's reports, we would not know a fraction of this very unsavory picture.

As I was doing all my reading in preparation for this hearing, two images kept coming back in my mind, both of them I wish I would not remember. Some 15 years ago, I chaired the Housing Subcommittee of this committee, and we had, I believe, 27 nationally televised hearings on waste and corruption and abuse and cronyism in the Department of Housing and Urban Development. It is the single most unpleasant episode of my congressional career and it revealed a series of appalling actions by high-ranking officials of the Department of Housing and Urban Development some 15 years ago.

Many years ago, during the Soviet period, the Russians produced some propaganda films taking little vignettes of the seamy side of American society, put them together, and presented them as accurately reflecting what the United States is. And not until the Hurricane Katrina nightmare, where we saw the seamy side and the incompetence of our society, did we have anything comparable to that, and we provided, through our news clips during the hurricane, devastating propaganda against the United States by the failure to prepare and by the failure to manage that crisis.

This crisis is, in many ways, worse. It is worse because it is an insult to our soldiers and Marines who are performing their jobs magnificently, with over 2,700 having lost their lives, a vast number permanently injured. We don't know how many with long-term psychological repercussions. And it is an insult to the American taxpayer. One really doesn't know whether to call this a theater of the absurd, where billions of American taxpayers' dollars were wasted in an obscene fashion; or whether to call it a chamber of horrors.

Now, I am fully aware, as I am sure every single member of this committee is, having visited Iraq, that it is a very difficult place to function in an orderly and normal fashion. We all understand the physical dangers, the unpredictability of the surrounding situation at any moment. But this degree of irresponsibility, incompetence, failure to engage in supervision and proper management practices boggles the mind. When our leaders at the highest levels say we want to stand up the Iraqi police and here we have this awful report about the police academy; when we hear about the need to improve health care, and 6 of 150 planned health care facilities are completed, one is speechless. It boggles the mind.

So Mr. Chairman, let me just say this hearing is long overdue. I am very pleased we are holding it. I am very pleased that we have, among other distinguished witnesses, the Inspector General, because I don't want to embarrass you with extreme praise, but you have done an outstanding job in documenting this chamber of horrors which confronts us.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Tom Lantos follows:]

News from Congressman

Tom Lantos

12th Congressional District of California
San Mateo/San Francisco

FOR IMMEDIATE RELEASE
September 28, 2006

FOR INFORMATION CALL
Lynne Weil (202) 225-6735

Verbatim, as delivered

Statement of Rep. Tom Lantos
House Government Reform Committee hearing,

Acquisition Under Duress: Reconstruction Contracting in Iraq

Thank you, Mr. Chairman. You and my friend Mr. Waxman have raised many of the specific issues that concern all of us. I would like to take a different tack.

But first, let me commend Mr. Bowen for the invaluable work you have done on behalf of the American people. If it were not for your Inspector General's reports, we would know a fraction of this very unsavory picture.

As I was doing all my reading in preparation for this hearing, two images kept coming back in my mind, both of them I wish I could not remember.

Some 15 years ago, I chaired the housing subcommittee of this committee, and we had, I believe, 27 nationally-televised hearings on waste and corruption and abuse and cronyism in the Department of Housing and Urban Development. It is the single most unpleasant episode of my congressional career, and it revealed a series of appalling actions by high-ranking officials of the Department of Housing and Urban Development some 15 years ago.

Many years ago, during the Soviet period, the Russians produced some propaganda films taking little vignettes of the seamy side of American society, put them together and presented them as accurately reflecting what the United States is. And not until the Hurricane Katrina nightmare, where we saw the seamy side and incompetence of our society, did we have anything comparable to that. And we provided through our news clips during the hurricane the material for devastating propaganda against the United States by showing the failure to prepare and the failure to manage that crisis.

This crisis is in many ways worse. It is worse because it is an insult to our soldiers and Marines who are performing their jobs magnificently, with over 2700 having lost their lives, a vast number permanently injured — we don't know how many — with long-term psychological repercussions. And it's an insult to the American taxpayer. One really doesn't know whether to call this a Theater of the Absurd where billions of American taxpayers' moneys were wasted in an obscene fashion or whether to call it a chamber of horrors.

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And when our leaders at the highest level say, "We want to stand up the Iraqi police," and here we have this awful report about the police academy, when we hear about the need for improving health care and 6 of 150 planned health care facilities are completed, one is speechless — it boggles the mind.

So Mr. Chairman, let me just say this hearing is long overdue, I am very pleased we are holding it, and I'm very pleased that we have, among other distinguished witnesses, the Inspector General — because (to Mr. Bowen), I don't want to embarrass you with extreme praise, but you have done an outstanding job in documenting this chamber of horrors which confronts us.

Thank you, Mr. Chairman

(End)

Chairman TOM DAVIS. Thank you very much.

Mr. Gutknecht.

Mr. GUTKNECHT. Just real briefly, Mr. Chairman. I won't give a political speech at all, but I just want to make it clear that part of the reason that we have as many inspectors general on this task is because we insisted, some of the conservative Republicans insisted that if we are going to be spending this much money, we want to make sure.

Mr. LANTOS. Mr. Chairman, a point of personal privilege. Did my colleague refer to me as he referred to a political speech?

Mr. GUTKNECHT. No. I said I am not going to give a political speech.

Mr. LANTOS. Was that a reference to my earlier comments?

Chairman TOM DAVIS. No, he made no reference to that.

Mr. LANTOS. I appreciate that.

Mr. GUTKNECHT. But the point really is, this is not a partisan issue. I think people on all sides of the political aisle want to make sure that when we are spending taxpayer dollars, that they are not wasted. And so, I share some of the outrage of all of my colleagues on all sides of the aisle.

The point I wanted to make is that the reason we have as many inspectors general poring over these, and the reason we have had seven hearings on these kinds of issues is because on both sides of the aisle, we think this is outrageous, and we want to get to the bottom of this. But most importantly, we want to put in place the accountability standards so this kind of thing stops. That is the key to this whole discussion today.

I yield back the balance of my time.

Chairman TOM DAVIS. Thank you very much.

Let me just note, we have held several subcommittee hearings on contracts in Iraq, and we have been waiting to get these reports together and working together on this. But this is important and I appreciate the Member's interest in this.

Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. Thank you for holding these hearings. I am looking forward to the testimony of the witnesses.

This is a question of competence or lack of competence, and the lack of accountability. You can look at the situation in Iraq today and clearly see that it is a mess. Despite the fact that the administration continues to tell us, just trust us, we know what you are doing. We need to go back and listen to what they told us before, and we remember when the President stood on the aircraft carrier, the USS Lincoln, back in May 2003, more than 3 years ago, under the banner, "Mission Accomplished."

And we know more than a year ago that Vice President Cheney went on national television and said, "The insurgency is in its last throes."

Those are statements made by the two top political leaders in our country. And yet we now know from a report that was released by the Pentagon just earlier this month that the situation in Iraq is dire, and that it is getting worse. That was a Pentagon report required by the U.S. Congress.

We now have an NIE just released that says that it is the consensus of all 16 U.S. intelligence agencies that Iraq continues to be a magnet for jihadists and the terrorist movement, has inspired terrorists around the world and has been a breeding ground for extremists.

So we need to have hearings on accountability and figure out how we got into this mess. In my own view, there were two wrong decisions. One was the initial decision based on what turned out to be false information. But the second part, and this is part of the exploration of the hearing today, is the post-invasion period, and the lack of planning for the post-invasion period.

The fact of the matter is, especially over at the Defense Department, which was given the main responsibility in the immediate aftermath of the war for reconstruction, you had an attitude started by the Secretary of Defense that this was going to be quick and easy, and we were going to be out of there. We don't have to plan. Back on September 9th, a story in the Washington Post headline, "Rumsfeld Forbade Planning for Post-War Iraq, General says." Brigadier General Mark Shea told the paper in an interview that Rumsfeld had said, "He would fire the next person who talked about the need for a post-war plan. The Secretary of Defense continued to push on us that everything we write in our plan has to be with the idea that we are going to be in, we are going to take out the regime, and we are going to be out of there, that we won't stay."

That is the mentality that infected the Defense Department planning when it came to these decisions. And so when it turned out we had to be there longer, we had to go into reconstruction, look what happened? Look what happened? Mr. Waxman has talked about the political cronyism that seeped into the decisionmaking.

We remember more than a year ago with Hurricane Katrina, people in the southern States got hit twice. They got hit first by the hurricane, and then they got hit by the incompetence of a FEMA that was headed by someone whose main credentials was that he had been the head of the Arabian Horse Breeders Association. They got hit twice, hurricane and incompetence.

And now we learn that on the major national security priority of our country, that same kind of mentality applied. I am just going to quote the headline from the article that Mr. Waxman referred to, "Ties to GOP Trumped Know-How Among Staff Sent to Build Iraq." You would think that what mattered most was expertise with respect to Iraq; expertise with respect to reconstruction; maybe people who knew the language; people who knew what they were doing. But according to this article, in order to pass muster with O'Beirne, who was a political appointee at the Defense Department who screened prospective political appointees for Defense Department posts, applicants didn't need to be experts in the Middle East or in post-conflict reconstruction. What seemed most important was loyalty to the Bush administration.

So yes, I think that both sides of the aisle should be outraged with the incompetence, but both sides of the aisle also need to begin to hold people accountable for the decisions that have been made. Mr. Waxman quoted the No. 2 guy in charge of reconstruction saying that as a result of this political cronyism, we didn't get

the best people for the job. And now we are here, many years later, wondering how things have gone so wrong in Iraq.

I think the story sort of tells itself. It is an unfortunate story. We need to do our best to begin to restore confidence of the American people in what we are doing in Iraq, but we have a lot of walking back to do in order to do that.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Do any other Members wish to give an opening statement?

Mr. MCHUGH. Mr. Chairman.

Chairman TOM DAVIS. Mr. McHugh.

Mr. MCHUGH. I am not going to make a statement, Mr. Chairman, but I just would like to hear the witnesses. It might be interesting. We are all interested in oversight. They may be helpful in that regard.

Just a sentence that follows the issue about being in Iraq. It says in the NIE, "Should jihadists leaving Iraq perceive themselves and be perceived to have failed, we judge fewer fighters will be inspired to carry on the fight." In other words, if we win, they lose.

I think if we are going to quote a 34-page paper, we ought to pull out more than just one sentence. This is too important an issue to distill it down like a Readers Digest.

I yield back.

Chairman TOM DAVIS. Thank you.

Mr. Kucinich.

Mr. KUCINICH. I would agree with my colleague that an in-depth approach is called for in a review of what has happened, where we are at, and where we are going. I think it is important to look at the type of thinking that took us into Iraq. There is a book out by Corn and Isakoff called Hubris, and page 200 has a quote that I think is instructive for purposes of this hearing. It says, "Post-war Iraq planning paralleled what happened with pre-war Iraq intelligence. The work of Government experts and analysts was discarded by senior Bush administration policymakers when it conflicted with or undermined their own hardened views about what to expect in Iraq."

So if we have a condition where there is a fundamental flaw in the world view of an administration, it harkens back to that biblical quote, "That which was crooked cannot be made straight." Everything about what happened in Iraq, from the lies that led us into it about WMDs, trying to connect Iraq with September 11th, trying to connect Iraq with al Qaeda's role in September 11th, trying to say Iraq was an imminent threat. There is symmetry here with the collapse of reconstruction, because it is the same type of thinking.

Today, we are here to discuss how the administration wasted billions of American and Iraqi taxpayer dollars. The goal is to find out where the money went and maybe ensure that the corruption does not continue. But we also need to ask the question: What are the effects of this failed reconstruction on Iraqi families? And then we need to ask: What are the combined effects of the first Gulf war, the economic sanctions throughout the 1990's, the 2003 shock-and-awe campaign, and its "collateral damage."

Abu Ghraib, and finally the failed reconstruction efforts, we know the administration has spent over $30 billion in taxpayer money to rebuild Iraq. The administration also spent an additional $20 billion in Iraqi funds under its control. Yet the administration has provided little relief for the suffering families in Iraq. We know Iraqis don't have adequate health care, schools, clean drinking water or roads. We know Iraqi children are suffering from diseases that do not threaten children in the developed world. We know that few Iraqis can claim they are better off now than they were when Saddam Hussein was in power.

We know that the U.S. sanctions against Iraq were perhaps the toughest, most comprehensive sanctions in history, the sanctions crippled the Iraqi economy during the time they were imposed, forcing much of Iraq's infrastructure into disrepair. UNICEF has put the number of child deaths related to Iraqi sanctions at 500,000. The reasons include lack of medical supplies, malnutrition and especially disease owing to the lack of clean water. Among other things, chlorine needed for disinfecting water supplies was banned as having a dual use in potential weapons manufacture.

For 1 minute, image yourself as an Iraqi mother or father. As any parent, your primary duty is to safeguard your family. But to do so, you have to overcome the effects of the first Gulf war, the economic sanctions through the 1990's, the 2003 shock-and-awe campaign, and its, "collateral damage," Abu Ghraib, and now the failed reconstruction efforts.

Is it any wonder that the Iraqi people want the United States to leave? Is it any wonder that the Iraqi people are hostile to a U.S. soldier? Is it any wonder that the National Intelligence Estimate found that our invasion and continued presence in Iraq is creating a larger terrorist threat?

We ought to refund back to the Iraqis the $9 billion in missing Iraqi money and we ought to pull out of Iraq as soon as possible as the Iraqis have made clear they desire.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you, Mr. Kucinich.

I think we are ready for our first panel now. Thank you for your patience. Members will have 7 days to submit opening statements for the record.

On our first panel, Katherine Schinasi, who is the Managing Director of the Acquisition and Sourcing Management, Government Accountability Office. Thank you for being here.

Stuart W. Bowen, the special inspector general for Iraqi construction. Thank you for being here.

Ambassador David Satterfield, the Senior Advisor to the Secretary for Iraq, U.S. Department of State. Thank you, Mr. Ambassador.

James Bever, Deputy Assistant Administrator for Iraq, Bureau for Asia and the Near East, U.S. Agency for International Development. Thank you for being here.

Tina Ballard, no stranger to this committee, Deputy Assistant Secretary for Policy and Procurement, the U.S. Army. Thank you for being here.

And Joseph Tyler, the Acting Deputy Director of Military Programs, U.S. Army Corps of Engineers. Thank you.

As you know, it is our policy, we swear witnesses in before you testify, so if you would rise with me and raise your right hands.

[Witnesses sworn.]

Chairman TOM DAVIS. Thank you. Let the record show all replied in the affirmative. Your entire statements are in the record. I read them last night. Our questions will be based on that. If you would like to supplement that or capsulize it, we would like you to stay within 5 minutes so we can move on. You have a red light in front of you. When the red light is on after 5 minutes, your time is up. It will turn orange after 4 minutes. It will green when you start.

Ms. Schinasi, we will start with you. Thank you again for being with us.

STATEMENTS OF KATHERINE SCHINASI, MANAGING DIRECTOR, ACQUISITION AND SOURCING MANAGEMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE; STUART W. BOWEN, JR., SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION; AMBASSADOR DAVID SATTERFIELD, SR., SENIOR ADVISOR ON IRAQ TO THE SECRETARY OF STATE; JAMES A. BEVER, DEPUTY ASSISTANT ADMINISTRATOR FOR ASIA AND THE NEAR EAST, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT; TINA BALLARD, DEPUTY ASSISTANT SECRETARY OF THE ARMY (POLICY AND PROCUREMENT); AND J. JOSEPH TYLER, ACTING DEPUTY DIRECTOR OF MILITARY PROGRAMS, U.S. ARMY CORPS OF ENGINEERS

STATEMENT OF KATHERINE SCHINASI

Ms. SCHINASI. Chairman Davis, Mr. Waxman, members of the committee, I appreciate the opportunity to be here before you today to talk about GAO's work on reconstruction contracting in Iraq.

I think I would just like to briefly touch on progress in three sectors that we have been tracking, and then turn specifically to the contracting challenges the United States is facing as it continues its reconstruction efforts.

As we and others have reported, the United States has not achieved outcomes from reconstruction efforts in Iraq as anticipated. As of August 2006, oil production was below pre-war levels and restoration of electricity and new or restored water treatment capacity remained below stated goals. One-third of DOD's planned construction work still needs to be completed, and the hope is now that will be done before the end of 2008.

Because the United States is relying so heavily on contractors to carry out reconstruction efforts, the strengths and weaknesses in how the Government has implemented its contracting process has a great bearing on the outcome of the U.S. efforts. The contracting problems we and others have reported on over the last several years are emblematic of contracting problems we have identified in numerous other situations, but have more dramatic consequences for failure as the nature of the task for the United States is so large and so costly.

We have made numerous recommendations to correct contracting problems we have identified, which the agencies have generally agreed with, but we continue to find that the practice is not always in line with the policy and guidance. When we reviewed the causes

for individual project decisions and outcomes, the problems we find tend to be interconnected, but they almost always start with requirements.

At the sector, program and project level, the failure to define realistic requirements, that is those that can be accomplished with available resources, makes it more difficult to take every subsequent step to get to a successful outcome. Without understanding the resources of time, money and capacity that are needed to achieve a stated requirement, reasonable estimates cannot be established. Without reasonable estimates at the start, program managers cannot stay on track.

The resulting instability has negative consequences on two levels. First, it affects individual projects as funding needs fluctuate, schedules slip and requirements are either added or dropped. Second, instability in individual projects has repercussions at the program and sector level, as money allocated for one use gets pulled away for other uses.

Without matching reform as to time, money and capacity resources before beginning projects, the cascading effect of the contract level is the inability to definitize contract terms and conditions. The resulting situation puts the Government at risk of having to accept costs that it might not otherwise bear. For example, recently reported that DOD contracting officers were less likely to remove costs questioned by the Department of Defense's Contract Audit Agency when the contractor had already incurred those costs.

Conversely, in the sample of DCAA audit reports we reviewed in which the negotiations took place before the work was started, the portion of questionable costs removed from the contractor's proposals was substantial.

Without agreed-upon requirements, terms and conditions, closer management and more oversight are needed, but more oversight requires more resources. There are numerous reported examples of not having enough skilled people on the ground. For example the design-build contracting approach, which was put in place for a large segment of the reconstruction work, by its very nature recognized the lack of sufficient Government resources as the United States turned to a contractor to manage contractors' performance.

In our June 2004 report, we also found that the lack of contract administration personnel contributed to shortfalls in contract performance. We have found that without sufficient people supporting project definition and execution, program officials have turned inappropriately to the use of interagency contracting vehicles, which is one of GAO's high-risk areas. We have reported both on the individual use of interagency contracts and on the breakdowns that occur throughout the process as a whole. One of the most significant of those is the role played by contractors in the process, which is usually reserved for Government personnel.

Finally, underlying market discipline offered by competition has not always been present, especially in the early stages of the reconstruction efforts. Competition can be used most effectively when advance planning occurs, which brings me back around to the need to establish realistic requirements at the beginning.

As I noted at the outset, these conditions are not new or unique in Iraqi reconstruction efforts. But understanding not just where we are today, but why is important to make corrections and prevent repeating mistakes. As our work has demonstrated, it is often not just one of these elements that leads to failed outcome, but a combination of several or sometimes all of them. Just as multiple factors are responsible for failure, multiple actors also share this responsibility.

So moving ahead to successful acquisition outcomes must also be a shared effort and responsibility between policymakers, program managers, contracting officers and the contractors themselves.

Mr. Chairman, that concludes my summary. I would be happy to take your questions.

[The prepared statement of Ms. Schinasi follows:]

United States Government Accountability Office

GAO

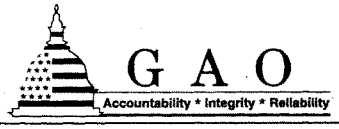
Testimony before the Committee on Government Reform, House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EDT
Thursday, September 28, 2006

REBUILDING IRAQ

Continued Progress Requires Overcoming Contract Management Challenges

Statement of Katherine V. Schinasi, Managing Director, Acquisition and Sourcing Management



GAO-06-1130T

September 28, 2006

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Highlights

Highlights of GAO-06-1130T, a testimony to the Committee on Government Reform, House of Representatives

REBUILDING IRAQ

Continued Progress Requires Overcoming Contract Management Challenges

Why GAO Did This Study

The United States, along with its coalition partners and various international organizations, has undertaken a challenging, complex, and costly effort to stabilize and rebuild Iraq. The Department of Defense (DOD) has responsibility for a significant portion of the reconstruction effort.

Amid signs of progress, the coalition faces numerous political, security, and economic challenges in rebuilding Iraq. Within this environment, many reconstruction projects have fallen short of expectations, resulting in increased costs, schedule delays, reduced scopes of work, and in some cases project cancellations.

This testimony (1) discusses the overall progress that has been made in rebuilding Iraq and (2) describes challenges faced by DOD in achieving successful outcomes on individual projects.

This testimony reflects our reviews of reconstruction and DOD contract management issues, as well as work of the Special Inspector General for Iraq Reconstruction.

In our previous reports, we have made several recommendations to improve outcomes in Iraq. DOD generally agreed with our recommendations.

What GAO Found

Overall, the United States generally has not met its goals for reconstruction activities in Iraq with respect to the oil, electricity, and water sectors. As of August 2006, oil production is below the prewar level, and the restoration of electricity and new or restored water treatment capacity remain below stated goals. One-third of DOD's planned construction work still needs to be completed and some work is not planned for completion until late 2008. Continuing violence in the region is one of the reasons that DOD is having difficulty achieving its goals.

The contracting challenges encountered in Iraq are emblematic of systemic issues faced by DOD. When setting requirements for work to be done, DOD made assumptions about funding and time frames that later proved to be unfounded. The failure to define realistic requirements has had a cascading effect on contracts and has made it difficult to take subsequent steps to get successful outcomes. For example, in the absence of settled requirements, agencies sometimes rely on what are known as undefinitized contract actions, which can leave the government exposed to increased costs. Further, DOD lacked the capacity to provide effective oversight and manage risks. We also found that DOD, at times, improperly used interagency contracts and was not able to take advantage of full and open competition during the initial stages of reconstruction. Just as multiple factors contribute to success or failure, multiple actors play a role in achieving successful acquisition outcomes, including policy makers, program managers, contracting officers, and the contractors themselves.

www.gao.gov/cgi-bin/getrpt?GAO-06-1130T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Katherine V. Schinasi at (202) 512-4841 or schinasik@gao.gov.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the contracting challenges the Department of Defense (DOD) faces in achieving successful acquisition outcomes in its efforts to stabilize and rebuild Iraq. The United States, along with its coalition partners and various international organizations, has undertaken a challenging and costly effort to stabilize and rebuild Iraq. This enormous effort is taking place in an unstable security environment, concurrent with Iraqi efforts to transition to a permanent government, and relies heavily on private companies for success. DOD has responsibility for a significant portion of the reconstruction efforts and has awarded and managed many of the large reconstruction contracts, such as contracts to rebuild Iraq's oil, water, and electrical infrastructure.

As we have previously noted, amid signs of progress, the coalition faces numerous political, security, and economic challenges in rebuilding Iraq.[1] For example, our recent assessment of the security situation in Iraq found that the conditions have deteriorated and grown more complex, as evidenced by the increased number of attacks and growing sectarian violence. Within this environment, many reconstruction projects have fallen short of expectations, resulting in increased costs, schedule delays, reduced scopes of work, and in some cases project cancellations. Poor acquisition outcomes are not unique to Iraq; we designated DOD's contract management activities as a high-risk area more than a decade ago. In our January 2005 high-risk report, we noted that DOD needs to use sound business practices when buying goods and services and have the right skills and capabilities in its acquisition workforce to properly manage these acquisitions.[2]

Today, I will briefly discuss the overall progress that has been made in rebuilding Iraq and then describe challenges faced by DOD in achieving successful outcomes on individual projects. This information is based on completed and ongoing reviews of efforts to rebuild Iraq that we have undertaken since 2003, as well as our work related to selected DOD

[1]GAO, *Rebuilding Iraq: Governance, Security, Reconstruction, and Financing Challenges*, GAO-06-697T (Washington, D.C.: Apr. 25, 2006); GAO, *Rebuilding Iraq: More Comprehensive National Strategy Needed to Help Achieve U.S. Goals and Overcome Challenges*, GAO-06-953T (Washington, D.C.: Jul. 11, 2006); and GAO, *Stabilizing Iraq: An Assessment of the Security Situation*, GAO-06-1094T (Washington, D.C.: Sep. 11, 2006).

[2]GAO, *High-Risk Series: An Update*, GAO-05-207 (Washington, D.C.: January 2005).

contract management issues. We conducted our reviews in accordance with generally accepted government auditing standards. In our previous reports, we have made several recommendations to improve outcomes in Iraq. DOD generally agreed with our recommendations.

My statement also considers the work of the Special Inspector General for Iraq Reconstruction, including audits of specific projects and lessons learned reports. We and other accountability organizations coordinate our oversight efforts with those conducted by the Inspector General to avoid duplication and maximize resources. In that regard, the Inspector General's ability to provide in-country oversight of specific projects and reconstruction challenges has enabled us to focus on national, sector, and interagency issues.

Summary

Overall, the United States generally has not met its goals for reconstruction activities in Iraq with respect to the oil, electricity, and water sectors. As of August 2006, oil production was below the prewar level, and the restoration of electricity and new or restored water treatment capacity remained below stated goals. One-third of DOD's planned construction work still needs to be completed and some work is not planned for completion until late 2008. Continuing violence is one of the reasons that DOD is having difficulty achieving its goals.

The contracting challenges encountered in Iraq are emblematic of systemic issues faced by DOD. When setting requirements for work to be done, DOD made assumptions about funding and time frames that later proved to be unfounded. The failure to define realistic requirements has had a cascading effect on contracts and has made it difficult to take subsequent steps to get successful outcomes. For example, in the absence of settled requirements, DOD sometimes relied on what are known as undefinitized contract actions, which can leave the government exposed to increased costs. Further, DOD lacked the capacity to provide effective oversight and manage risks. We also found that DOD, at times, improperly used interagency contracts and did not take advantage of full and open competition during the initial stages of reconstruction.

Background

The contracting processes, activities, and challenges associated with rebuilding Iraq can be viewed as similar to, albeit more complicated than, those DOD normally confronts. We and others have already reported on the large and continuing drain on reconstruction dollars to meet unanticipated security needs. Further, multiple players with diffuse and

changing responsibilities have had large roles in rebuilding Iraq, complicating lines of authority and accountability. Additionally, rebuilding a nation after decades of neglect and multiple wars is an inherently complex, challenging, and costly undertaking.

From May 2003 through June 2004, the Coalition Provisional Authority (CPA), led by the United States and the United Kingdom, was the United Nations recognized authority responsible for the temporary governance of Iraq and for overseeing, directing, and coordinating reconstruction efforts. During 2003, several agencies, most notably the U.S. Agency for International Development (USAID) and the U.S. Army Corps of Engineers, played a role in awarding and managing initial reconstruction contracts. To coordinate and manage the $18.4 billion in reconstruction funding provided in fiscal year 2004, the CPA established a multi-tiered contracting approach for Iraq reconstruction activities. The CPA, through various military organizations, awarded the following contracts: 1 program management support contract to oversee reconstruction efforts; 6 sector program management contracts to coordinate reconstruction efforts specific to each sector; and 12 design-build contracts to execute specific construction tasks. DOD is now emphasizing greater use of local Iraqi firms to perform reconstruction work that was previously intended to be performed by the design-build contractors.

With the establishment of Iraq's interim government in June 2004, the CPA's responsibilities were transferred to the Iraqi government or to U.S. agencies. The Department of State is now responsible for overseeing U.S. efforts to rebuild Iraq. The Project and Contracting Office (PCO), a temporary DOD organization, was tasked with providing acquisition and project management support. In December 2005, DOD merged the PCO with the U.S. Army Corps of Engineers Gulf Region Division, which now supervises DOD reconstruction activities in Iraq. Additionally, the State Department's Iraq Reconstruction and Management Office is responsible for strategic planning and for prioritizing requirements, monitoring spending, and coordinating with the military commander. USAID continues to award its own contracts, which are generally associated with economic assistance, education and governance, and certain infrastructure projects.

U.S. Efforts Have Produced Mixed Results in Restoring Iraq's Essential Services

The United States has made some progress in restoring Iraq's essential services, but as of August 2006, such efforts generally have not met prewar production levels or U.S. goals. Reconstruction activities have focused on restoring essential services, such as refurbishing and repairing oil facilities, increasing electrical generating capacity, and restoring water treatment plants. About one-third of DOD's construction work remains, and DOD estimates that some work is not planned for completion until late 2008. Continued violence, however, may make it difficult for the United States to achieve its goals.

For August 2006, the U.S. embassy reported that the oil, electricity, and water sectors generally performed below the planned U.S. goals. Specifically,

- Crude oil production capacity was reported as about 2.4 million barrels per day (mbpd), below the prewar level of 2.6 mbpd and the desired goal of 3 mbpd.
- In the electricity sector, peak generation capacity was reported at 4,855 megawatts, above the prewar level of 4,300 megawatts, but below the U.S. goal of 6,000 megawatts. Further, the current demand for power continues to outstrip the available supply of electricity as more Iraqis purchase consumer items and devices requiring electricity to operate.
- In the water sector, new or restored treatment capacity was reported at about 1.44 million cubic meters per day, compared to the U.S. goal of 2.4 million cubic meters.[3]

According to senior CPA and State officials responsible for the U.S. strategy, the CPA's 2003 reconstruction plan assumed that (1) creating or restoring basic essential services for the Iraqi people took priority over jobs creation and the economy and (2) the United States should focus on long-term infrastructure projects because of the expertise the United States could provide. Further, the strategy assumed that reconstruction efforts would take place in a relatively benign environment. The difficult security environment and persistent attacks on U.S.-funded infrastructure, among other challenges, contributed to project delays, increased costs, and canceling or reducing the scope of some reconstruction projects. As

[3]The data for the water sector is as of September 18, 2006.

we reported on September 11, 2006, the overall security conditions have grown more complex, as evidenced by increased numbers of attacks and Sunni/Shi'a sectarian strife. The continuing violence may make it difficult for the United States to achieve its goals.

Iraq Contracting Challenges Reflect Systemic Issues Faced by DOD

The contracting challenges encountered in Iraq are emblematic of systemic issues faced by DOD. A fundamental prerequisite to having good outcomes is a match between well-defined requirements and available resources. At the sector, program, and project levels, the failure to define realistic requirements has had a cascading effect on contracts and made it difficult to take subsequent steps necessary to get to successful outcomes. For example, in the absence of settled requirements, DOD has sometimes relied on what are known as undefinitized contractual actions, which were used extensively in Iraq and can leave the government exposed to increased costs. Managing risks when requirements are in flux requires effective oversight, but DOD lacked the capacity to provide a sufficient acquisition workforce, thereby hindering oversight efforts. In Iraq, as elsewhere, we found instances in which DOD improperly used interagency contracts to meet reconstruction needs. Finally, the underlying market discipline offered by competition can help promote better outcomes, but DOD, like other agencies, was challenged, particularly early on, in its ability to realize the benefits of competition. One or more of these factors can contribute to unsatisfactory outcomes on individual projects; the net effect, however, is that many reconstruction projects did not achieve their intended goals and DOD has incurred unanticipated costs and schedule delays.

Matching Requirements with Available Resources

One of the factors that can contribute to poor DOD acquisition outcomes is the mismatch between wants, needs, affordability, and sustainability. This mismatch was evident in the reconstruction efforts in Iraq. U.S. reconstruction goals were based on assumptions about the money and time needed, which have proven unfounded. U.S. funding was not meant to rebuild Iraq's entire infrastructure, but rather to lay the groundwork for a longer-term reconstruction effort that anticipated significant assistance from international donors.

To provide that foundation, the CPA allocated $18.4 billion in fiscal year 2004 reconstruction funds among various projects in each reconstruction sector, such as oil, electricity, and water and sanitation. As noted by the Special Inspector General, almost immediately after the CPA dissolved, the Department of State initiated an examination of the priorities and

programs with the objectives of reprioritizing funding for projects that would not begin until mid- to late-2005 and using those funds to target key high-impact projects. By July 2005, the State Department had conducted a series of funding reallocations to address new priorities, including increasing support for security and law enforcement efforts and oil infrastructure enhancements. One of the consequences of these reallocations was to reduce funding for the water and sanitation sector by about 44 percent, from $4.6 billion to $2.6 billion. One reallocation of $1.9 billion in September 2004 led the PCO to cancel some projects, most of which were planned to start in mid-2005. Changes, even those made for good reasons, make it more difficult to manage individual projects to successful outcomes.

Further, such changes invariably have a cascading effect on individual contracts. To produce desired outcomes within available funding and required time frames, DOD and its contractors need to have a clear understanding of reconstruction objectives and how they translate into the terms and conditions of a contract: what goods or services are needed, when they are needed, the level of performance or quality desired, and what the cost will be. When such requirements were not clear, DOD often entered into contract arrangements on reconstruction efforts that posed additional risks. For example,

- In June 2004, we reported that faced with uncertainty as to the full extent of the rebuilding effort, DOD often authorized contractors to begin work before key terms and conditions, including the work to be performed and its projected costs, were fully defined.[4] The use of undefinitized contract actions, while allowing needed work to begin quickly, can result in additional costs and risks to the government. We found that as of March 2004, about $1.8 billion had been obligated on reconstruction contract actions without DOD and the contractors reaching agreement on the final scope and price of the work. In one case, we found a contract action that had been modified nine times between March and September 2003, increasing estimated costs from $858,503 to about $204.1 million without DOD and the contractor reaching agreement on the scope of work or final price.

- In September 2005, we reported that difficulties in defining the cost, schedule, and work to be performed associated with projects in the

[4]GAO, *Rebuilding Iraq: Fiscal Year 2003 Contract Award Procedures and Management Challenges*, GAO-04-605 (Washington, D.C.: Jun. 1, 2004).

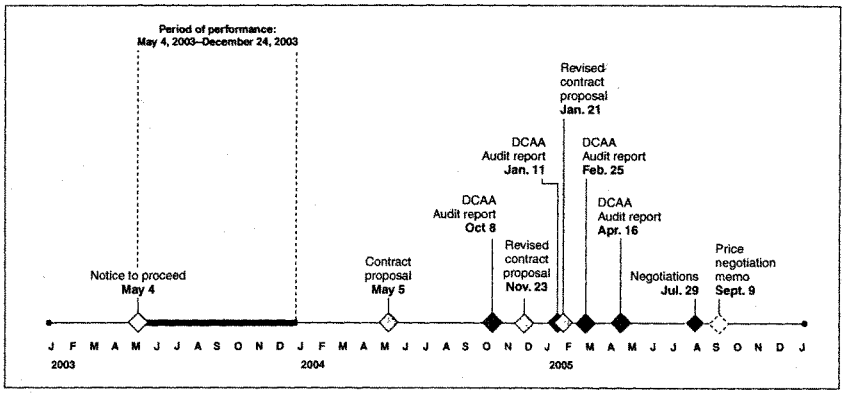
water sector contributed to project delays and reduced scopes of work.[5] We reported that DOD had obligated about $873 million on 24 task orders to rebuild Iraq's water and sanitation infrastructure, including municipal water supplies, sewage collection systems, dams, and a major irrigation project. We found, however, that agreement between the government and the contractors on the final cost, schedule, and scope of 18 of the 24 task orders we reviewed had been delayed. These delays occurred, in part, because Iraqi authorities, U.S. agencies, and contractors could not agree on scopes of work and construction details. For example, at one wastewater project, local officials wanted a certain type of sewer design that increased that project's cost.

- Earlier this week, we issued a report on how DOD addressed issues raised by the Defense Contract Audit Agency (DCAA) in audits of Iraq-related contract costs.[6] We again noted that DOD frequently authorized contractors to begin work before reaching agreement on the scope or price of the work. In such cases, we found that DOD contracting officials were less likely to remove costs questioned by DCAA from a contractor's proposal when the contractor had already incurred these costs. For example, of the 18 audit reports we reviewed, DCAA issued 11 reports on contract actions where more than 180 days had elapsed between the beginning of the period of performance to final negotiations. For 9 of these audits, the period of performance DOD initially authorized for each contract action concluded before final negotiations took place. In one case, DCAA questioned $84 million in its audit of a task order proposal for an oil mission. In this case, the contractor did not submit a proposal until a year after the work was authorized, and DOD and the contractor did not negotiate the final terms of the task order until more than a year after the contractor had completed work (see fig. 1). In the final negotiation documentation, the DOD contracting official stated that the payment of incurred costs is required for cost-type contracts, absent unusual circumstances. In contrast, in the few audit reports we reviewed where the government negotiated prior to starting work, we found that the portion of questioned costs removed from the proposal was substantial.

[5]GAO, *Rebuilding Iraq: U.S. Water and Sanitation Efforts Need Improved Measures for Assessing Impact and Sustained Resources for Maintaining Facilities*, GAO-05-872 (Washington, D.C.: Sep. 7, 2005).

[6]GAO, *Iraq Contract Costs: DOD Consideration of Defense Contract Audit Agency's Findings*, GAO-06-1132 (Washington, D.C.: Sep. 25, 2006).

Figure 1: Timeline of Key Contracting Events for Restore Iraqi Oil Contract, Task Order 5



Source: GAO analysis of DOD data.

Oversight and Workforce Issues

Instability—such as when wants, needs, and contract requirements are in a state of flux—requires greater attention to oversight, which in turn relies on a capable government workforce. Managing the attendant risks in unstable situations grows in both importance and difficulty. Unfortunately, attention to oversight and a capable government workforce has not always been evident during the reconstruction effort. Such workforce challenges are not unique to Iraq. DOD's civilian workforce shrank by about 38 percent between fiscal years 1989 and 2002, but DOD performed this downsizing without ensuring that remaining staff had the specific skills and competencies needed to accomplish future DOD missions. In other cases, contractors have taken over support positions that were traditionally filled by government personnel. For example, a contractor began providing intelligence support to the Army in Germany in 1999 and deployed with the Army to Iraq in 2003. The Army, however, found itself unprepared for the volume of Iraqi detainees and the need for interrogation and other intelligence and logistics services.

We and others have reported on the impact of the lack of adequate acquisition personnel and high turnover rates on reconstruction efforts. For example, among the lessons learned identified by the Special Inspector General was that one of the CPA's critical personnel shortcomings was the inadequate link between position requirements and necessary skills. In this case, gaps existed in the experience levels of those hired, as well as in the quality and depth of their experiences relative to their assigned jobs. Similarly, in January 2004, an interagency assessment team was sent to Iraq to review the CPA's contracting capability. The team found that existing contracting personnel were insufficient to handle the increased workload that was expected with the influx of fiscal year 2004 reconstruction funding and that the CPA needed more individuals with acquisition expertise who could help the programmatic side of the operation. In part, the CPA's decision to award seven contracts in early 2004 to help better coordinate and manage the fiscal year 2004 reconstruction efforts was in recognition of this shortfall. As a result, DOD finds itself in the position of relying on contractors to help manage and oversee the work of other contractors.

At the contract level, having personnel who are trained to conduct oversight, assigned at or prior to contract award, and held accountable for their oversight responsibilities is essential for effective oversight. Our work has shown that if oversight is not conducted, is insufficient, or is not well documented, DOD, and other reconstruction agencies, risk not identifying and correcting poor contractor performance in a timely manner and paying contractors more than the value of the services they perform.[7] For example,

- Our June 2004 report found that early contract administration challenges were caused, in part, by the lack of sufficient personnel.[8] We found that, due to the lack of government personnel to provide oversight, one contractor may have purchased $7 million in equipment and services that were not specifically authorized under the contract. Similarly, on another contract, to provide subject matter experts to the CPA and Iraqi ministries, DOD officials stated that some experts failed to report to duty or when they did, did not perform as expected. DOD officials attributed such performance issues to the lack of personnel to provide oversight when the experts arrived in Iraq.

[7]GAO, *Contract Management: Opportunities to Improve Surveillance on Department of Defense Service Contracts*, GAO-05-274 (Washington, D.C.: Mar. 17, 2005).

[8]GAO-04-605

- In July 2005, we noted that USAID obligated an additional $33 million on one of its contracts to pay for unanticipated increases in security costs, which left it short of funds to pay for construction oversight and quality assurance efforts, as well as to fund administrative costs.[9]

- Our September 2005 report on water and sanitation efforts found that frequent staff turnover affected both the definitization process and the overall pace and cost of reconstruction efforts.[10] For example, new contracting officers had to be brought up to speed and would sometimes ask the contractor to resubmit information in formats different from those previously required. A PCO official also noted that the contracting office in Iraq lacked sufficient staff and equipment and that some of the staff assigned as contracting officers lacked experience with the type of projects the PCO managed.

Using Interagency Contracting Vehicles

Another area in which workforce shortfalls proved problematic was in DOD's use and management of interagency contracting vehicles. We identified management of interagency contracting as a high-risk area in January 2005. In recent years, federal agencies have been making a major shift in the way they procure many goods and services. Rather than developing and awarding their own contracts, agencies are making greater use of contracts already awarded by other agencies, referred to as interagency contracting. This practice offers the benefits of improved efficiency and timeliness. Such contracts, however, need to be effectively managed, and their use demands a higher than usual degree of business acumen and flexibility on the part of the acquisition workforce. Our work and that of some agency inspectors general found instances of improper use of interagency contracting, resulting from increasing demands on the acquisition workforce, insufficient training, inadequate guidance, an inordinate focus on meeting customer demands at the expense of complying with sound contracting policy and required procedures, and the lack of clear lines of responsibility and accountability.

During the initial stages of reconstruction, we and the DOD Inspector General found instances in which DOD improperly used interagency contracts for many of the same reasons. For example,

[9]GAO, *Rebuilding Iraq: Actions Needed to Improve Use of Private Security Providers*, GAO-05-737 (Washington, D.C.: Jul. 28, 2005).

[10]GAO-05-872.

- In March 2004, the DOD Inspector General reported that a review of 24 contract actions awarded by a DOD component on behalf of the CPA revealed that DOD circumvented contracting rules, including improperly using General Services Administration federal supply schedule contracts and improperly contracting for personal services.[11] The Inspector General attributed this condition to the need to quickly award contracts and to DOD's failure to plan for the acquisition support the CPA needed to perform its mission.

- In June 2004, we noted that a task order awarded by the Air Force to provide logistical support and equipment to support USAID's mission in Baghdad and at other sites in Iraq was, in part, outside the scope of the contract.[12] The Air Force indicated that it was issuing additional guidance to ensure that future task orders were within the scope of the contract.

- In April 2005 we reported that a lack of effective management controls—in particular insufficient management oversight and a lack of adequate training—led to breakdowns in the issuance and administration of task orders for interrogation and other services by the Department of the Interior on behalf of DOD.[13] These breakdowns included

  - issuing 10 out of 11 task orders that were beyond the scope of underlying contracts, in violation of competition rules;

  - not complying with additional DOD competition requirements when issuing task orders for services on existing contracts;

  - not properly justifying the decision to use interagency contracting;

  - not complying with ordering procedures meant to ensure best value for the government; and

  - not adequately monitoring contractor performance.

[11]Office of the Inspector General, Department of Defense. *Acquisition: Contracts Awarded for the Coalition Provisional Authority by the Defense Contracting Command–Washington.* (Report No. D-2004-057, Arlington, Virginia, Mar. 18, 2004).

[12]GAO-04-605.

[13]GAO, *Interagency Contracting: Problems with DOD's and Interior's Orders to Support Military Operations*, GAO-05-201 (Washington, D.C.: Apr. 29, 2005).

Because officials at Interior and the Army responsible for the orders did not fully carry out their roles and responsibilities, the contractor was allowed to play a role in the procurement process normally performed by the government. Further, the Army officials responsible for overseeing the contractor, for the most part, lacked knowledge of contracting issues and were not aware of their basic duties and responsibilities.

Initial Inability to Benefit from Competition

Finally, one tool that can help mitigate acquisition risks is to rely on the discipline provided by market forces when contracts are awarded under full and open competition—that is, when all responsible prospective contractors are afforded the opportunity to compete. During the initial stages of reconstruction, we found that agencies were unable to take full advantage of competition, in part because of the relatively short time—often only weeks—to award the first contracts. Our June 2004 report found that agencies generally complied with applicable requirements for competition when awarding new contracts but did not always do so when issuing task orders against existing contracts. We found that 7 of the 11 task orders we reviewed were for work that was, in whole or in part, outside the scope of the existing contracts. In each of these cases, the out-of-scope work should have been awarded using competitive procedures or supported with a justification and approval for using other than full and open competition in accordance with legal requirements. Given the urgent need for reconstruction efforts, we noted that the authorities under the competition laws provided agencies ample latitude to justify their approach.

Such latitude presupposes that the rationale for such actions is valid; if not, then the loss of the benefits from competition cannot be easily justified. For example, in November 2005, we sustained a protest of a sole-source contract awarded by the Air Force in December 2004 for bilingual-bicultural advisers that was placed under an environmental services contract, which, on its face, did not include within its scope the bilingual-bicultural adviser requirement.[14] We concluded that the agency's efforts were so fundamentally flawed as to indicate an unreasonable level of advance planning. In the same decision, we sustained a protest of a second, follow-on sole-source contract awarded by the Air Force in July 2005 to the same company, in which the justification and approval prepared in support of the contract was premised on the conclusion that the contractor was the only responsible source, yet the capabilities of

[14] *WorldWide Language Resources, Inc.*, B-296984, Nov. 14, 2005, 2005 CPD P 206.

other firms were not in fact considered. The lack of advance planning, the failure to meaningfully consider other sources, and the attempts to justify the use of sole-source contracts originated, in large part, from the desire and pressure to meet the customer's needs in a short time frame. At the time of our decision, the initial contract was substantially complete, but we recommended that the agency promptly obtain competition for the requirement or prepare a properly documented and supported justification and approval for the second contract.

Overall, the Special Inspector General has reported that competition has improved for Iraq reconstruction projects since the early reconstruction efforts. Next month we will issue a congressionally mandated report that will provide an assessment of competition for actions subsequent to our June 2004 report.

Conclusions

The reconstruction contracting problems we and others have reported on over the last several years are emblematic of contracting problems we have identified in numerous other situations but with more dramatic consequences for failure, as the nature of the task for the United States is so large and so costly. While some of the factors I discussed today—mismatches between needs, wants, affordability, and sustainability; oversight and workforce challenges; improper use of contracting approaches; and competition issues—were more prevalent in the initial stages of reconstruction, the risks posed by others have not yet been fully mitigated. Understanding not just where we are today, but why, is important to enable DOD to make corrections and prevent repeating mistakes.

Just as multiple factors contribute to success or failure, multiple actors play a role in achieving successful acquisition outcomes, including policy makers, program managers, contracting officers, and the contractors themselves.

Looking to the future, about one-third of DOD's planned construction work remains to be completed, including some work that is not planned for completion until the end of 2008. It is not too late for DOD to learn from its past difficulties and provide adequate oversight on these remaining projects. Delivering these projects on time and within cost is essential if we are to maximize the return on this investment and make a difference in the daily lives of the Iraqi people and help to provide the services they need—safe streets, clean water, reliable electricity, and affordable health care.

Mr. Chairman and members of the committee, this concludes my prepared statement. I will be happy to answer any questions you may have.

Scope and Methodology

In preparing this testimony, we relied primarily on our completed and ongoing reviews of efforts to rebuild Iraq that we have undertaken since 2003, as well as our work related to selected DOD contract management issues. We conducted these reviews in accordance with generally accepted government auditing standards. We also reviewed audit reports and lessons learned reports issued by the Special Inspector General for Iraq Reconstruction and work completed by the Inspector General, Department of Defense. We conducted this work in accordance with generally accepted government auditing standards in September 2006.

GAO Contacts and Staff Acknowledgments

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Chairman TOM DAVIS. Thank you very much.

Mr. Bowen, thank you for being with us.

STATEMENT OF STUART W. BOWEN, JR.

Mr. BOWEN. Thank you, Mr. Chairman, and thank you, Ranking Member Waxman and members of the committee for having me here to testify today about SIGIR's oversight of Iraq reconstruction. And thank you, Mr. Chairman, for your support of my office since its inception 2½ years ago.

Mr. Chairman, you said accurately in your opening statement that not everything is wrong in Iraq, and that is true. A fair reading of our full reports demonstrably underscores that fact. Indeed, 70 percent of the projects we visited and 80 percent of the money allocated to them indicate that those projects, from a construction perspective have met what the contract anticipated.

Mr. Gutknecht pointed out that oversight is not a partisan issue. That is absolutely correct and is the approach that I take to this issue and I think is the right approach. It is the message that I give my auditors, inspectors and investigators. I just returned Monday from a 50 day trip to Iraq, where I met with senior U.S. leaders in the reconstruction programs, senior Iraqis involved in it, in the anti-corruption fight, and also visited sites outside the Green Zone.

I learned a lot. I learned from General Corelli, the commander of the multinational Corps Iraq, the troops on the ground, the guy who is looking out for our soldiers there, that the solution in Iraq is not primarily military. It is an economic and political one. And what that means is that it underscores the paramount importance of succeeding in the reconstruction program moving forward, and that means, as the chairman pointed out, we need to learn our lessons. That is something that SIGIR has pushed forward in real time in the course of carrying out our mission.

In January, we did a lessons-learned report on human capital management, effectuated some positive changes in how personnel are managed in Iraq. We released a report in August on contracting and procurement in Iraq, and it has prompted responsiveness. Paul Brinkley in the Business Transformation Agency under Deputy Secretary England's direction are making a real-time difference in trying to improve how contracting is done over there, and more to the point, changing the system so that it operates better moving forward.

Ambassador Khalizad has strongly supported our mission, as did Ambassador Satterfield when he was DCM and now is senior advisor to Secretary Rice, and Ambassador Speckhard. As a result, our audits, when they finally see the light of day in writing, mostly have their findings resolved, because they have been recognized by management, the issues raised by them, that is, and the problem is addressed, at least solutions put in place.

So it is true. A week ago I visited a site that is outer-city, the Baghdad Police College. It was an extremely disappointing visit. It is essential that we succeed on the security front. The Baghdad Police College is the place where police will be trained. Phil Galioto, the dean there, pulled me aside and was really in distress about the fact that he had to close that college for 2 weeks because of its

unsanitary conditions, and his fear that he was going to have to close it again when he has this parade of recruits that are lined up ready to come through and learn how to bring security to Baghdad.

The reality is that those issues are out there, but the reality also is, as he told me, is the oversight was prompting change. Indeed, the resources he was seeking and said he needs are moving forward to address the significant problems there.

Mr. Chairman, you asked us to address contracting issues. I am happy to discuss the lessons-learned report. They are the subject of potential pending legislation from Senator Collins and are I think aimed at adjusting the system to improve contracting. But the point of my contracting report ultimately is that the story of Iraq reconstruction from a personnel perspective, from a contracting perspective, and from a program and project management perspective, we are writing that report now. It will be out in December. It is a story of gradual progress. It is a story of adapting, learning lessons, and improving the execution in a situation where security is a fundamentally overriding matter.

I would be happy to address in the question and answer section primary health care issues and the Basrah Children's Hospital issue that you were concerned about.

Thank you for this time.

[The prepared statement of Mr. Bowen follows:]

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STATEMENT OF STUART W. BOWEN, JR.

SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

BEFORE THE

U.S. HOUSE COMMITTEE ON GOVERNMENTAL REFORM

OVERSIGHT HEARING ON: RECONSTRUCTION CONTRACTING IN IRAQ

SEPTEMBER 28, 2006

WASHINGTON, D.C.

Chairman Davis, Ranking Member Waxman, and members of the Committee—thank you for this 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.

I was appointed as the Inspector General of the Coalition Provisional Authority in January 2004 and began oversight of the CPA programs and operations with about a dozen staff in Baghdad in March of that year. Our work began only a few months before the June 28 disestablishment of the CPA.

The Office of the Special Inspector General was created in October 2004, only two months before the scheduled termination of the CPA Inspector General. This renewed and extended our mandate to promote economy, efficiency and effectiveness, and to prevent and detect waste, fraud and abuse in the administration of programs and operations supported by the Iraq Relief and Reconstruction Fund (IRRF).

SIGIR reports jointly to the Secretaries of State and Defense to keep them fully informed about problems and deficiencies in IRRF programs and operations, as well as the need for corrective action. Our reports are provided directly to the Congress and made available to the public.

In addition to the ten Quarterly Reports we have provided to Congress since our initial report in March 2004, we have issued 125 audit and project assessment reports. Today, SIGIR criminal investigators have 89 open cases. They have referred 25 cases to the Department of Justice, four of which have resulted in convictions.

I feel strongly that the oversight we have provided to the reconstruction of Iraq has enhanced the value of this investment of the American taxpayer. The establishment of the office of SIGIR was the right thing to do. As the Special Inspector General, I thank you for giving us the opportunity to make this important contribution. And, as an American, I thank you for ensuring that there is an independent government watchdog to oversee Iraq reconstruction.

Significant problems have been uncovered by SIGIR auditors, inspectors and investigators, and we have worked with reconstruction managers to address solutions. We have uncovered waste, abuse and fraud. We have helped to improve efficiency and effectiveness, and those who have committed fraud are being brought to justice.

Our reports have documented many disappointing and disturbing matters, and these have been given public attention. However, most of our reports also document conditions where we uncovered problems, made recommendations for corrective actions that were accepted and these recommendations implemented by reconstruction managers.

SIGIR inspectors, who travel frequently outside the Baghdad "Green Zone" to assess on-site the progress of reconstruction projects often find that contract expectations have been met. Our inspectors have reported on projects that represent more than $308 million in contract value. Of this total, almost $250 million, or about 80 percent, have met contract specifications. Moreover, this figure understates the dollar value of projects meeting contract expectations because some of the projects selected for assessments are requested by reconstruction management and staff because of known or suspected problems

While these figures are not statistically significant, we take encouragement from the evidence that much of the work has met contract expectations. Considering the high level of danger in areas of the Iraq war zone, which threatens those who are at construction sites, building, managing and inspecting the projects, it is all the more important to recognize the progress that has been achieved.

As I have stated, despite the progress, there have been significant problems with projects many documented by the work of SIGIR auditors, inspectors and investigators. The Chairman's invitation to testify at this oversight hearing asked me to address root causes of these difficulties, and specifically the problems with construction of the Primary Healthcare Centers and the Basrah Children's Hospital project.

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The Primary Healthcare Centers project began with a March 2004 contract for 150 centers in Iraq, at a definitized contract cost of about $243 million. Over the next two years, little progress was made, despite the expenditure of about $186 million. By March 2006, because of the lack of progress, the number of centers to be built had been reduced by eight, to 142. Of these,135 centers were only partially constructed, one was placed under a different contract, and only six were accepted as completed by the U.S. Army Corps of Engineers. The government then issued a "termination for convenience" for 121 of the 135 partially completed centers, leaving a requirement for the contractor to deliver 20 completed centers, including the six already completed.

The additional cost to separately complete the other 121 centers is estimated to be about $36 million, and the U.S. Army Corps of Engineers this month announced the award of contracts for the centers.

We found that both contractor performance and U.S. Government management actions were factors in the failure to complete the Public Healthcare Centers project as planned. We were told by the U.S. Army Corps of Engineers that the contractor:

- Lacked qualified engineering staff to supervise its design work;
- Failed to check the capacity of its subcontractors to perform the required work;
- Failed to properly supervise the work of its subcontractors; and,
- Failed to enforce quality assurance and quality control activities.

SIGIR auditors identified:

- A lack of complete government response to contractor requests for equitable adjustments and excusable delays based on unplanned site conditions, design or scope changes, or delays based on site access restrictions or security;
- High government personnel turnover and organizational turbulence;
- Failure to follow required procedures for making contract changes;
- Poor cost controls;
- Poor cost-to-complete reporting;
- Failure to properly execute its administrative responsibilities; and,
- Failure to establish an adequate quality assurance program.

While we did not dispute the U.S. Army Corps of Engineers' list of contractor problems, the Federal Acquisition Regulations, if they are followed, provide sufficient controls to ensure the government receives the goods or services it seeks at a fair and equitable price. Thus, our Audit report focused on the government's contract administration.

The SIGIR audit report concluded that the overall management of the projects could have been better executed, noting the unfortunate result that 121 centers were not completed. We provided recommendations for the project, as well as additional "lessons learned" for contract oversight. Some responses we received from the three government organizations involved in the management of this project indicated that no one office had taken responsibility. Moreover, despite the reported shortcomings of the contractor, it is the government's responsibility to

oversee the contract. Given that the government was aware of problems with the project for some time, we believe that effective government contract oversight was not provided.

[The SIGIR audit report on this matter is submitted for the record: Audit Report on Management of the Primary Healthcare Centers Construction Projects (SIGIR-06-011), April 29, 2006, at: http://www.sigir.mil/reports/pdf/audits/06-011.pdf]

A SIGIR audit also found effective program management and oversight lacking for the Basrah Children's Hospital Project. The U.S. Agency for International Development (USAID) was tasked with construction of a modern, 50-bed pediatric facility in Basrah in southern Iraq, intended to improve the quality of care for both women and children. Congress authorized $50 million for the project. Under a memorandum of understanding with USAID, Project HOPE would provide a significant portion of the hospital equipment and have responsibility for training staff.

Instead of the 50-bed facility with referral-level pediatric care, with an emphasis on pediatric oncology, as requested by the Iraqi Ministry of Health, the initial design presented was for a 100-bed facility, encompassing over 25,000 square meters of space. The scope was subsequently modified to a 94-bed facility with oncology services and radio therapy facilities. These modifications did not result in any request for additional funding or extension of the project schedule.

The job order issued by USAID in August 2004 to Bechtel National, Inc. required that the hospital be completed by December 2005. Over the next year, completion of the project slipped several times and by March 2006, it was projected as July 31, 2007. Additionally, project delays and a revision in the allocation of indirect costs, had resulted in an increase of the estimated cost-at-completion to approximately $98 million.

While the project status reports provided to USAID regularly identified slippages in the project, SIGIR auditors found that the information was not effectively analyzed. Moreover, this information was not included in reports to Congress required under Section 2207 of P.L. 108-106 or Project Assessment Reports.

Although USAID is responsible for the construction of the hospital, it did not include the installation of medical equipment in the project schedule or costs. The USAID Mission Director-Iraq told SIGIR that they did not believe they were required to track or report on the medical equipment. However, USAID is responsible for keeping the Congress and the Chief of Mission accurately apprised of the hospital's status. The Deputy Chief of Mission told SIGIR that he was unaware that the completion date reported by USAID did not reflect the delivery of a turnkey operation that would include medical equipment.

SIGIR found the USAID accounting systems and processes to be inadequate; they failed to accurately identify and report project costs to the Chief of Mission and Congress. The April Section 2207 Report to the Congress stated the hospital cost-at-completion as $50 million, even though Bechtel had determined it would be at least $98 million. USAID told SIGIR that it

believed it did not have to include an estimated $48 million in contractor indirect costs in its reports.

The SIGIR audit report stated our belief that under the current management and contracting structure, the actual turnkey cost for the project will be about $149.5 million to $169 million. We also believe that the project will require an additional $69.5 million to $89.5 million of additional funds to complete.

Oversight and management of the Basrah Children's Hospital Project schedule and cost have been hampered by the lack of effective program management and oversight by the Department of State and USAID. The Chief of Mission, responsible for the supervision and direction of all U.S. assistance programs, did not establish a management structure for carrying out that responsibility.

Similarly, USAID did not establish an appropriate program management structure. To oversee its entire $1.4 billion construction program under the Iraq Relief and Reconstruction Fund (IRRF), comprising approximately 20 projects across eight infrastructure sectors, USAID relied on one administrative contracting officer and one cognizant technical officer. No appointment was made of a program manager with sole responsibility for the hospital project, nor was a hospital program management office established.

In May and June 2006, the Deputy Chief of Mission and the director of the Iraq Reconstruction Management Office (IRMO) took a number of actions to get control of the contract. A "Stop work" order was issued; followed by another about a month later. The Deputy Chief of Mission directed USAID and IRMO to provide specific information on the project.

The U.S. Mission-Iraq concurred with all of the recommendations of the SIGIR audit, and provided information on actions underway. Notably, the Ambassador has created and chairs a Reconstruction Core Group which includes all agencies involved in reconstruction. This group has devised a plan to complete the project, transferring program and project management for the Basrah Children's Hospital from USAID to the U.S. Army Corps of Engineers.

The Ambassador has also issued an instruction to all agencies that implement assistance under his authority to provide IRMO with accurate and complete information on projects. He also directed USAID to work with IRMO to establish reporting systems that assure that information reflects the most accurate possible direct and indirect cost allocations by projects and programs.

We consider actions taken and planned by the U.S. Mission are fully responsive to our audit report.

[The SIGIR audit report on this matter is submitted for the record: Review of the U.S. Agency for International Development's Management of the Basrah Children's Hospital Project (SIGIR-06-026) July 31, 2006, at: http://www.sigir.mil/reports/pdf/audits/06-026.pdf]

In our audits, project assessments and Quarterly Reports to Congress, SIGIR has expressed concern for management weaknesses similar to those cited in the Public Health Centers and Basrah Hospital reports. For example, beginning in 2004, when SIGIR was still the Coalition Provisional Authority Inspector General, we noted the difficulty with obtaining reliable estimates of the costs to complete projects, which are mandated by Congress. A year later, SIGIR raised the question: *Can the U.S. government agencies managing Iraq reconstruction projects produce reliable estimates of the costs of completing these projects (and thus avoid over-obligating funds)?* Moreover, a SIGIR audit found that the IRMO information systems failed to produce the required cost-to-complete data, and thus projections could not be made on the funds available for completion of the IRRF program.

The development of fully functional information management systems for Iraq reconstruction suffered many delays. SIGIR conducted a series of audits addressing the information technology and management systems, and we were able to report progress only this past April. The delays in establishing effective IT and management systems deprived the Iraq reconstruction management effort of essential visibility of its own operations. This has contributed to failures such as documented with the Public Health Centers and Basrah Children's Hospital projects.

In addition to our audits and inspections, SIGIR is taking a longer view of the Iraq reconstruction experience, to analyze the issues such as those that led to today's oversight hearing. We wanted to get at the "root causes" of failure and derive the lessons and provide guidance to policymakers with future challenges. This was the conception of the SIGIR Lessons Learned Initiative.

In February, we published our first such report, "Iraq Reconstruction: Lessons in Human Capital Management." In August we released our second report covering lessons in contracting and procurement. The third and final in this series, Lessons in Program and Project Management, will be published in the fall.

While these reports are not traditional work products of inspectors general, they should carry the authority you would expect of the work of an inspector general. I want to assure the committee that they have been produced through appropriately rigorous processes.

The most recent report on lessons learned in contracting tracks the evolution of reconstruction contracting and procurement processes from the summer of 2002, before the creation of the Office of Reconstruction and Humanitarian Assistance (ORHA), through to the present. For example, we present a detailed chronology of events and decisions related to contracting, including the expansion of the DOD LOGCAP program beyond its original purpose, the minimal role for the State Department in initial planning, and how security considerations limited the coordination of inter-agency planning.

We examine the creation, deployment and disestablishment of ORHA, and the creation of the CPA. The report discusses the use of the Development Fund for Iraq (DFI) for CPA contracts, the first U.S. appropriated reconstruction funds, and the development of requirements for much more appropriated support. We report on how the management of entire effort came down to the creation of a wholly new organization, which was denied adequate support for months, and had

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to reach out to other government contracting offices for support. The creation of a strategy for acquisition management, which used a design-build approach giving contractors oversight over infrastructure sectors, is discussed in detail.

The report looks at the problems of the transition to State Department management after the summer 2004 termination of the CPA, how the contracting processes are slowed by security and information problems, and the continuing evolution of contracting methods. Special contracting programs, such as the Commanders Emergency Response Program (CERP) are examined, as well.

We distilled key lessons for contracting and procurement in Iraq to provide insight for policy and planning, as well as for policies and processes.

Strategy and Planning Key Lessons:

- **Include contracting and procurement personnel in all planning stages for post-conflict reconstruction operations.** The pre-deployment interagency working groups for Iraq reconstruction did not adequately include contracting and procurement personnel.

- **Clearly define, properly allocate, and effectively communicate essential contracting and procurement roles and responsibilities to all participating agencies.** The failure to define contracting and procurement roles and responsibilities at the outset resulted in a subsequently fragmented system, foreclosing opportunities for collaboration and coordination on contracting and procurement.

- **Emphasize contracting methods that support smaller projects in the early phases of a contingency reconstruction effort.** The Commander's Emergency Response Program (CERP) and similar initiatives in Iraq proved the value of relatively small, rapidly executable projects that meet immediate local needs.

- **Generally avoid using sole-source and limited-competition contracting actions.** These exceptional contracting actions should be used as necessary, but the emphasis must always be on full transparency in contracting and procurement. The use of sole-source and limited competition contracting in Iraq should have virtually ceased after hostilities ended (and previously sole-sourced limited competition contracts should have been promptly re-bid).

Policy and Process Key Lessons:

- **Establish a single set of simple contracting regulations and procedures that provide uniform direction to all contracting personnel in contingency environments.** The contracting process in Iraq reconstruction suffered from the variety of regulations applied by diverse agencies, which caused inconsistencies and inefficiencies that inhibited management and oversight.

- **Develop deployable contracting and procurement systems before mobilizing for post-conflict efforts and test them to ensure that they can be effectively implemented in contingency situations.** Contracting entities in Iraq developed *ad hoc* operating systems and procedures, limiting efficiency and leading to inconsistent contracting documentation.

- **Designate a single unified contracting entity to coordinate all contracting activity in theater.** A unified contract review and approval point would help secure the maintenance of accurate information on all contracts, enhancing management and oversight.

- **Ensure sufficient data collection and integration before developing contract or task order requirements.** The lack of good requirements data slowed progress early in the reconstruction program.

- **Avoid using expensive design-build contracts to execute small scale projects.** While the use of large construction consortia may be appropriate for very extensive projects, most projects in Iraq were smaller and could have been executed through fixed-price direct contracting.

- **Use operational assessment teams and audit teams to evaluate and provide suggested improvements to post-conflict reconstruction contracting processes and systems.** Oversight entities should play a consultative role (along with their evaluative role), because the rapid pace of reconstruction contingency programs cannot easily accommodate the recommendations of long-term assessments or audits.

Our Study has resulted in six recommendations:

1. **Explore the creation of an enhanced Contingency Federal Acquisition Regulation (CFAR).** Although the existing FAR provides avenues for rapid contracting activity, the Iraq reconstruction experience suggests that the FAR lacks ease of use. Moreover, promoting greater uniformity through a single interagency CFAR could improve contracting and procurement practices in multi-agency contingency operations. An interagency working group led by DOD should explore developing a single set of simple and accessible contracting procedures for universal use in post-conflict reconstruction situations. Congress should take appropriate legislative action to implement the CFAR, once it is developed by the interagency working group.

2. **Pursue the institutionalization of special contracting programs**. In Iraq, smaller scale contracting programs, like the Commander's Emergency Response Program (CERP) and the Commanders Humanitarian Relief and Reconstruction Program (CHRRP), achieved great success. Congress should legislatively institutionalize such programs for easy implementation in future contingency operations.

3. **Include contracting staff at all phases of planning for contingency operations.** Contracting plays a central role in the execution of contingency operations, and thus it must be part of the pre-deployment planning process. Whether for stabilization or reconstruction operations, contracting officials help provide an accurate picture of the resources necessary to carry out the mission.

4. **Create a deployable reserve corps of contracting personnel who are trained to execute rapid relief and reconstruction contracting during contingency operations.** This contracting reserve corps could be coordinated by the DoS Office of the Coordinator for Reconstruction and Stabilization as part of its civilian ready reserve corps. An existing contingent of contracting professionals, trained in the use of the CFAR and other aspects of contingency contracting, could maximize contracting efficiency in a contingency environment.

5. **Develop and implement information systems for managing contracting and procurement in contingency operations.** The interagency working group that explores the CFAR should also review current contracting and procurement information systems and develop guidelines and processes for enhancing these existing systems or, if necessary, creating new ones to meet unique contingency operational needs.

6. **Pre-compete and pre-qualify a diverse pool of contractors with expertise in specialized reconstruction areas.** These contractors should receive initial reconstruction contracts during the start-up phase of a post-conflict reconstruction event.

Our report on lessons learned in program and project management will provide comparable insight and insight into these aspects of Iraq reconstruction, and provide guidance for the future.

In just over a month, SIGIR will submit to you our eleventh Quarterly Report to the U.S. Congress, reflecting our work and observations of Iraq reconstruction over the quarter that ends in two days.

My most recent tour in Iraq was longer than has been my practice; I spent 48 days, about two weeks longer than usual, as this is a critical period in the Iraq reconstruction. With expiration of the funds of IRRF2, and thus the need for all of these funds to be under contract when the fiscal year ends, I wanted to be present.

SIGIR remains committed to meeting the expectations of the U.S. Congress, the Secretaries of State and Defense, and the American public with timely and helpful information on U.S. progress and performance in Iraq reconstruction.

I look forward to your questions.

Chairman TOM DAVIS. Thank you.

Ambassador Satterfield, thanks for being with us.

STATEMENT OF AMBASSADOR DAVID SATTERFIELD, SR.

Mr. SATTERFIELD. Thank you, Mr. Chairman, Ranking Member Waxman, members of the committee. I appreciate the opportunity to testify today before this committee on the progress we have made to date on Iraq reconstruction, and also on the steps we have taken to execute more effectively our oversight responsibilities and ensure that the taxpayers' moneys are spent wisely, effectively and to good purpose for the United States and good purpose for the people of Iraq.

We recognize fully the enormous responsibility we have to deliver tangible benefits to the Iraqi people, to manage honestly and effectively the billions of dollars with which we have been entrusted. We don't intend to underestimate or understate the mistakes that have been made, but we also do not wish to understate the successes that have been achieved, for there have been significant successes, successes in the face of perhaps the most difficult operating environment in the world.

Success is critical in Iraq in terms of our ability, Iraq's ability and the support of the international community to economic development and growth. Security measures alone, as General Corelli and others have said, cannot secure a stable, peaceful Iraq. Only security measures augmented by good governance, progress on reconciliation, and development and growth of Iraq's economy to provide a stake for all of Iraq's citizens in a different, more peaceful Iraq can achieve those goals.

We believe thoughtful, detailed, oversight can strengthen our management of contracts and improve outcomes on the ground. It already has. Over the last year, we have undergone a sea-change, literally, in how we award, manage and monitor contracts. We have shifted more contracts to Iraqis, revised cost-to-complete accounting procedures, moved away from design-build and cost-plus contracts, and have given grants directly to Iraqi ministries. In short, we have learned from the past. We are adapting. We will continue to adapt to changing conditions on the ground.

We take seriously and we apply in real-time, lessons learned from the excellent sustained work of the Special Inspector General for Iraq Reconstruction, our colleague Stu Bowen, the Government Accountability Office, as well as the Inspectors General from the Department of State, USAID, and the Defense Contract Audit Agency. We look forward to the committee's observations and suggestions to help us further improve this work.

I would like to begin with a brief review of what the IRRF funds have accomplished, acknowledge the difficulties we have encountered, and review the specific mechanisms that we have put in place to tighten oversight of this program.

I would like to begin by outlining what we have achieved. IRRF-funded projects have had a measurable and significant impact on the lives of Iraqi citizens, but I want to make a comment at the beginning. This impact, this positive impact comes against the backdrop of the magnitude of need in Iraq for basic infrastructure development. That is a need estimated by the World Bank in 2004

at over $100 billion. It was never our intent to meet through U.S. funds all of these goals. Our intent was to begin a process, to start a process which Iraqi efforts themselves and the support, the strong support, the vital support of the international community and the Middle East itself, Iraq's neighbors, would be required to complete.

Electricity, our projects have added, rehabilitated or maintained almost 3,000 megawatts of electricity generation. What this means is about one-third of all of the power transmitted today, this day, to Iraq's citizens comes as a result of our efforts and our funding. Other projects have succeeded in rehabilitating Iraqi equipment that will provide, when infrastructure is improved for transmission, still more ability to deliver power.

On water, our projects have improved significantly. Access to fresh water and to sewage treatment services have included 19 major water treatment plants, as well as smaller projects that have improved access to drinkable water. Five million Iraqis have access today to clean water and sewage services as a result of our efforts. That is not insignificant, and completion of all of our planned projects will bring drinkable water to an additional 8 million Iraqi citizens.

Before the war, Baghdad had no functional sewage treatment plants. All sewage was simply dumped into the Tigris River, polluting all downstream consumption. Nine major plants have been rehabilitated and have capacity to serve 5 million Iraqis. Three of these plants are in Baghdad, two-thirds of the city's population are being served by what they do. That is not insignificant.

Our funding has rehabilitated or refurbished over 4,000, that is over 30 percent, of Iraq's schools, trained 60,000 teachers, provided over 8 million new textbooks, and we have inoculated through the efforts of AID virtually all of Iraq's children against the diseases of polio and measles.

Oil production, vital to that country's economic future, production and exports as a result of our efforts have increased above 2002 pre-war levels. Exports have also exceeded pre-2002 efforts. That is not insignificant.

We have also had setbacks, including work on the primary health care centers and the Basrah Children's Hospital, and like my colleagues, I am prepared to address those issues in response to committee questions. But I want to stress in closing, the lessons learned here. We have tightened, in our mission in Iraq and here in Washington, the procedures through which we oversee contracting, through which we assess the situation on the ground. We have improved the way we do our accounting numbers so that we can have a real-time estimate of funds available, and can shift those funds within the parameters set by the Congress to meet changing priorities on the ground. We want to work with the committee. We want to work with our oversight agencies with the various auditing systems in place now, to improve still further our work. Lessons have been learned and will continue to be applied on the ground as we seek to better ensure that the taxpayers' money is spent wisely and all benefit from those funds.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Satterfield follows:]

Sept. 27

Ambassador David Satterfield,
Senior Advisor on Iraq to the Secretary of State
Statement Before the Government Reform Committee
September 28, 2006

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify before the House Government Reform Committee today. Together with my colleagues from the Army Department, the U.S. Army Corps of Engineers (ACE), and U.S. Agency for International Development (USAID), we welcome the opportunity to discuss progress we have made to date on Iraq reconstruction, and the process of overseeing the large number of contracts involved.

With the permission of the Committee, I would like to begin with a brief review of what IRRF has accomplished, acknowledge the problems we have encountered, and review the steps we have taken to respond. I will also discuss the specific interagency mechanisms we have put in place to ensure good oversight of this very large program.

At the outset, I would like to make one point clear. The State Department has taken its responsibilities for overall coordination and oversight very seriously, and continues to apply lessons learned, including suggestions from our auditors, the Special Inspector General for Iraq Reconstruction (SIGIR) and GAO, as well as the OIG from State, USAID and the Defense Contract Audit Agency. The IRRF addresses a uniquely broad range of issues, from standing up the Iraqi Security Forces to fostering democracy and restoring essential services. The sheer breadth of the program, as well as the amount of money Congress generously provided, meant that we had to design a new approach, which draws on several implementing agencies to take advantage of their special expertise, such as USAID, DOD Treasury, Justice, USDA, USIP and others. While this has made our overall program more robust, this approach has also required

consistent attention to coordinate implementation of projects and program oversight. While the majority of IRRF projects have been or are being completed successfully, we have made mistakes along the way. We have also had to work through some unexpected challenges. Starting last summer, Ambassador Khalilzad and General Casey instituted significant changes in the Embassy's operations, including IRMO's organization, to improve military-civilian coordination. These measures have already delivered results, and have improved coordination among implementing agencies and tightened our project oversight. We have also increased the amount of direct contracting with Iraqi firms, which both improves their capacity and avoids some of the problems we have experienced with international contractors.

Changing Iraqi Needs and the U.S. Response

The needs of Iraq's government and people have changed since the beginning of our assistance programs in 2003, and they will continue to evolve. We have carefully managed the IRRF to support the most critical projects and our FY 2006-7 foreign assistance requests to support Iraq's transition to greater self-reliance. The Iraq Relief and Reconstruction Fund (IRRF) was designed to be adjustable to respond to developments on the ground and Iraq's changing needs. Initially the IRRF focused on providing the critical infrastructure needed to kick-start Iraq's economy and national institutions. We are now completing this stage, and expect that most major infrastructure projects will be finished by the end of 2006. In 2004, we also responded to developments on the ground by increasing our support for the Iraqi armed forces and police. Similar to our efforts on infrastructure, we have largely completed programs using the IRRF to stand up the Iraqi armed forces and police. As we shift our assistance focus from infrastructure, we are increasing our focus on building the capacity of Iraq's ministries.

IRRF's Record

IRRF-funded projects already have had a significant impact on the lives of average Iraqis. IRRF I and II projects have added, rehabilitated or maintained more than 2,700 megawatts (MW) of electricity generation capacity on the grid. New and rehabilitated units now typically provide 25 percent to 30 percent of the country's electricity generation capacity. Other existing units are providing power today only because of IRRF maintenance activities. The balance in electricity distribution has also been changed from the previous regime's practice of delivering power to Baghdad at the expense of the rest of the country.

Despite these improvements, grid power still satisfies only about half of the country's demand for electricity. To improve this performance will require major additional investments in generation capacity and, above all, the coordinated development of the country's electricity and oil sectors. It will also require sustained improvements in Iraqi maintenance of existing distribution and transmission lines, as well as generation facilities, and better protection of critical transmission lines against insurgent attack. In addition, reform of electricity tariffs will help temper the growth of demand, which continues to increase exponentially.

IRRF projects also have improved access to fresh water and to sewage treatment services. The projects have included 19 major water treatment plants as well as smaller projects that improve access to drinkable water in underserved rural areas. The projects have improved access to fresh water benefiting 4.6 million Iraqis, and increased access to sewage treatment services benefiting 5.1 million Iraqis. Completion of all planned projects will bring drinkable water to an additional 8.2 million Iraqis. Before the war, Baghdad had no functional sewage

treatment plants – raw sewage was simply dumped into the Tigris River, polluting the drinking water of downstream residents. Nine major sewage treatment plants have been rehabilitated and have the capacity to provide an additional five million Iraqis with sewage treatment services. Three of these nine sewage treatment plants are in Baghdad and have the capacity to serve about 2/3 of the city's population.

While our focus in the past was on building-up basic capacity in essential services, we have moved forward and are now concentrating our efforts on helping the Iraqis deliver them. Our goal is simple. We want all Iraqis to see, feel, and touch our accomplishments at the faucet, light switch, and stove. And we're making progress in that direction.

We are also making advances on behalf of Iraq's children. Approximately 32 percent of Iraq's 14,121 school buildings were rehabilitated or refurbished, 60,000 teachers have been trained, and 8.7 million new textbooks were provided to Iraqi school children all through IRRF funds. Nearly all Iraqi children have been inoculated against crippling diseases such as polio and measles, and hundreds of health clinics throughout Iraq have been rehabilitated.

Iraq's crude oil production and exports have increased above 2002 pre-war levels. In September 2006, production has averaged 2.36 million barrels a day, above the 2002 average of 2.0 million barrels per day. Iraq's crude oil exports have increased above 2002 pre-war levels. In September 2006, exports averaged 1.53 million barrels a day, above the 2002 average of 1.3 million barrels per day.

IRRF Management

To manage this unique program, we recognized that we had to create a unique management structure. To manage IRRF II, in 2004, we created the Embassy's Iraq Reconstruction Management Office (IRMO) to act as the agency overseeing all IRRF contracts. On a day to day basis, this involves coordinating among the five Congressionally-authorized IRRF implementing agencies, the largest two of which are DOD and USAID, to integrate and prioritize reconstruction efforts. IRMO compiles the reports from implementing agencies into the reports we submit to Congress, primarily the Section 2207 report on Iraqi reconstruction. In addition to IRMO, my office of Special Advisor to the Secretary on Iraq and my colleagues in the Near East Bureau directly support on a daily basis the management efforts of the Embassy and IRMO.

IRMO acts primarily as an overseer of U.S. assistance projects in Iraq, but also has played an important advisory role in a number of Iraqi ministries. IRMO is not a contracting agency. Rather, it oversees the contracting agencies such as USAID and PCO, ensuring that projects continue to support overall U.S. policy objectives. Every effort is taken to ensure that project funding allocated to civilian and defense agencies with a proven contracting track record. Depending on the size, complexity, and nature of the project, IRMO staff may be closely involved in reviewing the Requests for Proposals and subsequent Scopes of Work. This is particularly critical when projects are one part of a more complicated system, as is often the case in the essential oil, electric and water sectors. IRMO relies on its implementing partners to manage projects, and monitors progress through regular reporting, extensive consultations with Iraqi ministries and other international actors, and field visits. Given the security situation,

contractors face severe difficulties in project execution, and contract oversight faces similar challenges.

IRMO has learned from past mistakes and taken action to make improvements in its monitoring mechanisms. It began a process of radically revising "cost-to-complete" account procedures in early 2005. For ten months, we worked with SIGIR to determine ways to revise these procedures to monitor more effectively whether projects are achieving their stated goals on time and on budget. When project costs appear excessive relative to the work performed, such as was the case with Basra Children's Hospital (BCH) and the Primary Healthcare Centers (PHCs), IRMO and its partner agencies can investigate the cause of such variances and take appropriate action. Inspectors General and other oversight bodies are key partners in such monitoring.

Contracting Lessons Learned

Throughout this experience in managing more than 3,000 contracts, we have learned a number of management and contracting lessons. On the management side, we have worked hard to improve interagency coordination on the ground, as well as in Washington. While there is still some room for improvement, we now have a much more accurate, real-time sense of the status of projects across the broad spectrum of IRRF. This improved management and coordination will serve us well as we implement the FY06 Supplemental programs.

On the contracting side, we have also made several improvements. In 2005 we identified creative and flexible contracting approaches to implement reconstruction efforts more effectively and at lower cost to respond to delays and increased costs caused by insurgent attacks. One

avenue involves contracting directly with Iraqi firms and labor to the greatest extent possible, instead of working through large design-build contractors. This allows us to disburse funds more quickly, while reducing security risks to Americans and lowering overhead costs.

We have also implemented a pilot program that provides IRRF grants directly to Iraqi line ministries with a demonstrated capacity to manage projects. This has lowered overall costs of contracts between 30 and 40 percent, created additional Iraqi contracting opportunities and employment, and enhanced overall Iraqi engagement in the reconstruction process. The Army's Project and Contracting Office (PCO) has provided a grant to the Iraqi Ministry of Construction and Housing (MoCH) for it to contract directly with Iraqi firms to build roads and bridges. Under this system, PCO helps the ministry set project milestones under the contract, and works with the ministry inspectors to verify that these milestones have been met before releasing payment to the Iraqi contractor. This approach has already been expanded to the Ministries of Electricity, Industry, Municipalities and Public Works and Water Resources. We also appreciate the Congress authorizing, in the FY 2005 Defense Authorization Act, simplified contracting procedures for certain procurements, thereby expediting the reconstruction efforts of all USG agencies in Iraq.

Primary Health Care Centers and Basrah Children's Hospital

I can provide two case studies to illustrate how our project management process has worked, one involving the Army Corps's Project Contracting Office, one which involves USAID. Both of these projects are important parts of our integrated strategy to improve the Iraqi health care sector. The project to build primary health care centers was intended to strengthen

the backbone of the Iraqi health sector by creating model institutions offering a high standard of primary and preventive care. In addition to projects to rehabilitate a number of hospitals across the country to improve secondary care, we also planned to build a modern tertiary care facility in Basrah offering state of the art pediatric care.

Let's begin with the primary health care facilities. In 2004, the Army Corps issued a contract with a design build company to build 142 model Primary Healthcare Centers (PHC). By the summer of 2005, project reviews began to show the projects were behind schedule for a number of reasons, including difficulty in mobilizing workers for all of the sites and some difficulties with selecting some of the sites. PCO worked with the contractor to get the projects back on schedule. When this engagement failed to solve the problem, PCO escalated the level of its engagement, progressively involving senior USACE, IRMO and Embassy officials. After a prolonged attempt to resolve the situation with the company, PCO and IRMO identified an alternative to complete the project. In early April 2006, the original contract for the PHCs was terminated for convenience due to insufficient progress. The USG accepted a total of 20 PHCs from the contractor in April (including six accepted by the Ministry of Health). Construction on the remaining PHCs was about 67% complete on average at the time of contract cancellation. A Congressional Notification for $62.3M to complete the remaining PHCs was approved in June. PCO then awarded contracts directly to Iraqi companies to finish the remaining construction. As of Aug. 31, all of the PHC contracts have been awarded. Construction is complete on seven PHCs, and some centers are averaging over 200 patients per day.

This experience indicated that we should shift away from design build and cost plus contracts to fixed price contracts. We have reduced the involvement of large multinational firms

and increased work with Iraqi firms that have proven themselves as successful contractors. Based on the lessons learned in this project, we have instituted changes in other contracts as well.

Basrah Children's Hospital

The second example is Basrah Children's Hospital. The Administration allocated $50 million in IRRF in 2004 to build the Basrah Children's Hospital (BCH). USAID was responsible for construction. By the spring of 2006, it had become clear that the contractor was significantly behind schedule, and over budget. While some of the fault lies with the contractor, and some of the delay came as a result of the worsening security situation, it is also clear that the mission had not exercised tight enough oversight of this project to keep it on track. As of mid-September, the facility is roughly 35% complete and the $50 million in funding has been exhausted.

The Embassy conducted a complete review of the project's status in June, with the help of an independent assessment team. The Embassy and IRMO identified the specific problems, and determined a way forward. As part of this strategy, IRMO proposed a change in implementer to the Army Corps to take advantage of their greater resources to deal with security issues. The strategy also suggested shifting to a direct contract with a local firm, which will result in significant savings. The Embassy's strategy required an additional $67.4 million, beyond the initial $50 million, to complete the hospital. Based on our experience to date, we have built in significant contingencies for security and other potential cost overruns. We have also instituted quarterly Cost to Complete assessments to keep closer watch on the pace of progress. One of our international partners has committed to providing $22 million of the $67.4 million total.

These two examples illustrate the problems which we have encountered in some of the projects along the way. They also illustrate the nature of the challenges in responding to the evolving security situation on the ground, as well the process of adaptation we have used to adjust to these challenges in project management. While we are not pleased that we have experienced these problems, we have learned important lessons from our mistakes, and have taken steps to improve our project management. We cannot guarantee that we won't have problems with other projects in future, but we will continue to look for ways to improve our management. It is also worth noting that an important part of the solution we employed in both instances is to increase the emphasis we place on contracting directly with Iraqi contractors. Three years ago, Iraqi contractors simply lacked the experience and resources to undertake many of these projects, particularly the larger ones. As their capabilities have grown, we have turned more towards Iraqi contractors, which are often better able to deal with issues like security.

International Compact with Iraq

I would like to take the opportunity to update you on several important ongoing issues, most importantly the International Compact with Iraq. The United States continues to work with other donors to coordinate efforts on assisting Iraq. Among the most important initiatives in this area is the International Compact with Iraq, an initiative of the Iraqi government and the United Nations launched July 27, 2006 in Baghdad. The Compact will provide a new framework for mutual commitments between Iraq and the international community, particularly Iraq's neighbors. Iraq will commit to the reforming its main economic sectors (e.g., oil, electricity and agriculture), and to establishing the laws and building the institutions needed to combat corruption, assure good governance and protect human rights. In return, the various members of

the international community will commit to providing the financial, technical and other forms of assistance needed to support Iraqi efforts to achieve economic and financial self-sufficiency over the next five years.

Members of the Iraq Compact Preparatory Group endorsed the concept of the Compact at a meeting hosted by the United Arab Emirates on September 10 in Abu Dhabi. The Preparatory Group plans to meet three more times in October to prepare a final draft of the Compact documents. On September 18, at high level meetings held alongside the U.N. General Assembly meeting in New York and the IMF/World Bank meeting in Singapore, the ministers of foreign affairs and finance from more than 35 countries and institutions expressed their strong support for the Compact. A joint letter sent by the U.N. and Iraq after the New York meeting called for the formal signing of the Compact before the end of November. We are particularly grateful for the statements of support from Iraq's neighbors for the Compact, including their participation in the meetings in Abu Dhabi, Singapore and New York. We also welcome the statements of support coming from regional organizations such as the Arab Fund for Social and Economic Development, the League of Arab States, and the Organization of the Islamic Conference.

It is too early to say precisely how much additional donor assistance, whether financial or technical, will be provided under the Compact. It is clear already, however, that the Compact can enhance the efficacy and increase the real benefits of current and future donor assistance. As part of the process of formulating its side of the Compact the Iraqi government is coming to terms with its own weaknesses. Under the Compact, with its specific goals and benchmarks, the government of Iraq will be taking ownership and responsibility for making the necessary

improvements. Moreover, the Compact will broaden the base of support and interest in Iraq's reconstruction from the United States and the Coalition to a much larger group of countries - especially Iraq's neighbors. The Compact will not replace the International Reconstruction Fund Facility for Iraq (IRFFI), but rather will help IRFFI to deliver donor assistance -- old and new -- in a more targeted and effective manner.

Finally the Compact aims explicitly to bring increasing amounts of private capital into Iraq since international businesses and investors will ultimately have a greater impact on Iraq's future than government assistance. Thus, Iraq's commitments to basic economic reforms and good governance will be particularly important to Iraq's economic success over the long term.

Capacity Development

I also wanted to update you on our efforts to build Iraqi governing capacity at the central and local level, as well as to sustain essential services projects. We have established the National Capacity Development Program (NCDP), which helps the GOI strengthen the core functions necessary for the efficient administration of its key national ministries, the Prime Minister's Office, Inspectors General of the participating ministries, and anti-corruption organizations such as the Commission on Public Integrity (CPI) and the Board of Supreme Audit (BSA). The NCDP is currently working with $25 million in reallocated IRRF funds; $125 million in FY2006 supplemental funds, and the Administration has requested an additional $25 million in the 2007 budget. The program is organized into two phases to enable rapid response to short-term priorities while at the same time building the foundation to meet longer-term needs.

Ministry Advisory Teams (Mat's), composed of experts from the Mission, Iraqi officials, as well as donors, provide policy and programmatic advice and work jointly with the ministries to develop and resolve ministry priorities. The MATs and the NCDP are supported by PM Maliki, and he has designated an Iraqi lead in his office. The longer-term NCDP track will focus on revitalizing Iraqi training institutions; civil service reform; and other broad goals.

The Embassy completed detailed scopes of work for projects to meet urgent capacity building needs in specific ministries. The USG will provide immediate support to ministries as well as long-term capacity-building assistance in the core functions. For example, the implementation of a Financial Management Information System (FMIS) across Iraqi ministries will increase transparency by standardizing financial reporting, budget execution and procurement, and satisfies the IMF recommendations for rebuilding public expenditure management in Iraq. The longer-term NCDP contract will also increase the capacity of national and regional public administration centers to train ministry employees.

The United States continues to work with Iraq to effectively operate USG-funded infrastructure projects in the near term and improve its ability to sustain critical infrastructure. The USG initially allocated $121 million to the electricity sector to support sustainable operations for generation facilities, while another $25 million USG program supported operations and maintenance in twelve water and sewage treatment plants. More recently, the USG allocated $180 million of IRRF to continue sustainment efforts in the electricity and water sectors and provide support to additional sectors ($110 million in the water sector, $61 million in the electricity sector, and $9 million in the combined areas of

communications/transportation/health) to help Iraq sustain its infrastructure. These programs are expected to keep Iraqi plants and facilities online, thereby improving the levels of service offered to the Iraqi people. Congress generously provided $345 million in the FY 2006 supplemental legislation to continue both sustainment and capacity development efforts at plant-level facilities. The Administration has requested an additional $154 million in the FY 2007 budget to help Iraq set up programs to maintain its essential service infrastructure for years to come.

Security

Finally let me close with a few remarks on security first addressing Security Transition and then the Baghdad Security Plan (BSP).

We are actively continuing to help train and equip the Iraqi Security Forces (ISF) to enable them to assume responsibility for Iraq's security. This process is producing results -- in September the MOD and the Joint Headquarters took command of two of the Iraqi Army's ten divisions, the Coalition has trained and equipped more than 300,000 individuals, including Ministry of Defense and Ministry of Interior personnel, for service in the ISF; and Dhi Qar became the second province to transition to Iraqi security control.

While progress in developing Iraq's military is being made, the effort to stand up an effective police force is facing more challenges. To address these problems, the Iraqi Ministry of Interior, with the assistance of Coalition Forces, has begun a three-phased National Transformation Plan to assess National Police Battalions' current capabilities, reinforce police training and establish practices for continuing education of the police forces. The goal in this

Transformation Plan is to create a highly professional police force, loyal to the Government of Iraq, and operating with the trust and confidence of the Iraqi people in accordance with the Rule of Law and international standards of Human Rights.

Prime Minister al-Maliki launched Phase II of the Baghdad Security Plan (BSP) in August 2006. While reactions to the BSP have been positive, Iraqis still indicate they do not trust the ISF because of perceived sectarian motives. The BSP also includes an important multi-agency civilian effort with the GOI, AID and others in such areas as electricity distribution, fuel availability, sewage, and black marketing. As of September 21: More than 32,500 man-days of labor on cleanup and economic development. Over 126,000 cubic yards of trash, over 80,000 buildings cleared, and more than 1500 weapons seized.

Operation Lion's Gate – fortification of 28 entrances to Baghdad will be tightly controlled by Iraqi Police. A series of obstacles (natural and man made) constricts movement through authorized checkpoints, to keep terrorists and extremists and criminals from using other routes. Finally, BSP Phase III will focus on the security transfer of Baghdad district-by-district to the Iraqis.

As the ISF—both the military and the police—stands up and achieves an acceptable level of training and readiness to maintain public order, and as the institutions of government develop greater capacity, we will adjust our military presence and roles accordingly.

Sept. 27

Mr. Chairman, Ranking Member, ladies and gentlemen thank you very much for the opportunity to make these opening remarks and I look forward to your questions.

Chairman TOM DAVIS. Thank you very much.

Mr. Bever, thanks for being with us.

STATEMENT OF JAMES A. BEVER

Mr. BEVER. Thank you, Mr. Chairman and members of the committee. USAID thanks you for the honor of being able to be here with you this morning.

First, I would like, as a U.S. Foreign Service Officer, to thank the chairman and members of the committee for the times when you come to the field and see what we do in the field, and you take the risks that we also take as Foreign Service Officers in the field so you understand the challenges that are there, and you bring us courage that what we do to serve our country is the right thing. Thank you.

In addition to the support for democratic infrastructure building and economic infrastructure building in the ministries of finance, I would like to focus my very brief comments on the physical infrastructure. There are some things that USAID and American taxpayer dollars have done today which we take for granted. First is Umm Qasr Port. The dredging of that port, the repair of that port early on in this conflict allowed hundreds of thousands of tons of supplies to come in to the Iraqis in a timely fashion.

The repair of the airport, both in Baghdad and Basrah, has allowed thousands of commercial and civilian flights to come in and out of Iraq and around Iraq. Thousands of small infrastructure projects in every one of the provinces of Iraq have allowed the visible, tangible manifestation of American goodwill and caring and improvement at the local level.

Ambassador Satterfield has also commented on the power sector, and has commented on the water and wastewater. I won't go further on that, except to say that we have also been very active in the rural areas. This is where 25 percent of all the jobs are created and maintained in Iraq. So much of our assistance has been in building agricultural infrastructure, and 500,000 farmers have water today that didn't have it a few years ago.

The Ambassador also addressed our contribution to education and to health. I won't go further there.

I would like to just close, and I will make my comments very brief, by saying that our agency, recognizing the importance of Iraq, recognizing the importance of SIGIR and of GAO and the IG comments, has created a Special Deputy Assistant Administrator position specifically for Iraq. I was brought in by Ambassador Tobias, our Administrator, from Israel where I was serving for the last 2 years to help enhance Israel's security, and advance Congress' plans both there and in Afghanistan before that, to focus on Iraq. So we welcome and look forward to continuing to work with our accountability agencies. We are proud of the Government Accountability Office finding that USAID competitively awarded contract actions for 99 percent of all of our obligations and commitments.

And last comment, under our infrastructure activities, we are also very proud that 97 out of 99 of our activities have now been completed. The remaining two will be completed in the coming year

and we will be sharing those activities with Army Corps and transferring them shortly.

Thank you.

[The prepared statement of Mr. Bever follows:]

TESTIMONY OF JAMES A. BEVER
DEPUTY ASSISTANT ADMINISTRATOR FOR
ASIA AND THE NEAR EAST
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
BEFORE THE
COMMITTEE FOR GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES
SEPTEMBER 28, 2006

Mr. Chairman, members of the Committee, it is an honor to appear before you today. I welcome the opportunity to testify on behalf of the U.S. Agency for International Development (USAID). Today, I would like to describe to the Committee USAID's contribution to the reconstruction of Iraq.

The President's National Strategy for Victory in Iraq lays out a clear path forward in helping Iraq become a stable, and secure democracy in the Middle East and ally in the war on terror. The President's plan focuses on three areas – security, political, and economic. USAID programs support all three tracks of this plan, and in coordination with our partner agencies, we are creating a new Iraq with a constitutional, representative government that is able to harness its economic potential to create jobs and other opportunities for its people and is a functioning and helpful international partner. The fundamental operating principle of this strategy is that transition to Iraqi self-sustainment and responsibility cannot be made without integrated progress on all three tracks.

Since March 2003, USAID has been allocated approximately $5.1 billion in Iraq Relief and Reconstruction Funds (IRRF). Of this amount, we have disbursed approximately $4.4 billion. USAID has spent almost $2.5 billion on infrastructure projects. The majority of individual projects have been completed according to our expectations. I want to reiterate: our successes dwarf our failures, despite what you may hear in the press. I want to summarize some of our accomplishments.

Accomplishments

First, USAID is working with U.S. and multinational units to help cities recover from the effects of fighting and revitalize the local economy. USAID projects are closely coordinated with, and support, Department of Defense CERP projects to ensure maximum effectiveness of resources. These projects consist of a combination of small, rapid activities, followed by more complex projects that operationalize public services, promote representative local government, and help resuscitate the economy. USAID's implementing partners provide the majority of project monitoring with assistance from the military as needed. USAID is continuing this effort through our new Focused Stabilization Office and Community Stabilization Project, which will help Iraq build more peaceful communities by providing more economic opportunities primarily to men ages 17-24 who may be more prone to engage in violent activities.

Second, USAID-managed programs are facilitating democratic transformation in Iraq. USAID worked with the United Nations, the United Kingdom, Canada, and the European Community to support the successful constitutional referendum, in October 2005, and two national elections, in January and December 2005. Our programs have also provided expert assistance, drawing from the international community and Iraqi civil society, to assist the Iraqi Constitutional Drafting Committee. USAID continues to support building the capacity of provincial and city authorities to provide essential services. In the field, assistance teams work with the Provincial Councils to help them shoulder the burden of decentralized power.

Third, on the economic front, USAID has worked with Treasury, and other agencies to help build Iraqi governing capacity, particularly at the Central Bank of Iraq and Ministry of Finance. Our assistance to the Ministry of Finance, through the design and placement of a Financial Management Information System (FMIS) in 95 sites countrywide, is providing the GOI with the ability to track its budget and expenses. Through increased statistical gathering and analysis provided by the Central Office of Statistics and Technology, USAID is improving Iraq's ability respond and provide assistance to the Iraqis in the most need. USAID provides technical assistance for Iraqi World Trade Organization accession. These efforts have also enabled Iraq to provide quality budget data to the International Monetary Fund (IMF), facilitating the completion of IMF lending agreements and supporting the Paris Club debt rescheduling agreements.

Fourth, USAID projects have added 1,292 megawatts of new or rehabilitated electrical generation capacity to the national grid. To help safeguard these investments, USAID and other agencies are providing limited support to help the Iraqis operate and maintain these systems. In telecommunications, USAID has overseen the instillation of 12 domestic switches and one international switch, the restoration of international calling service, and the completion of a consolidated fiber optic network that connects electricity and communications sectors and will allow Ministry of Electricity officials to monitor and control the electrical grid from three central locations, greatly improving the reliability of electric power service to Iraqis.

USAID partners have refurbished or expanded 19 water treatment plants in five cities in Iraq increasing the supply of potable water from USAID projects to over 3.1 million Iraqis. USAID projects have also provided sewage treatment to over 5.1 million people and have provided plant-level operations and maintenance training and support at major potable water and sewage treatment plants nationwide to ensure that these plants continue to function. In addition, USAID's rural water program has installed over 70 small water treatment systems in rural communities of less than 5,000 people throughout Iraq. The rural water program will help to supply clean water to over 400,000 villagers each day.

Fifth, USAID is helping to build a long-term sustainable economy through our agricultural assistance programs. USAID's Agriculture Reconstruction and Development Program for Iraq (ARDI), recognized the critical importance of this sector to the country, is generating real jobs that sustain livelihoods – tens of thousands per week according to

employment records in 2006. The program is managed by a small core of expatriate technical advisers and a larger team of 250-300 Iraqis through five offices across the country with less than 8 percent of project funds going towards security.

Through improvements to the canal and water infrastructure, made possible by small-scale grants, 445,000 Iraqi farmers now have improved efficiency of irrigation or access to water on 320,000 acres of farmland. ARDI has also established date palm nurseries in 13 governorates that will expand the true to type palm tree population by 410,000 new trees a year. Throughout the country, ARDI has planted 9,000 olive trees in 16 demonstration plots, which will produce high value oil.

Sixth, other USAID activities are focused on providing a better future for Iraq by investing in the future of the country's children and youth. A demographic youth bulge threatens Iraq's future. In 2004, half of all Iraqis were under the age of 20 years old. Given current population growth rates, the population will double by 2030. Iraq currently has some of the lowest literacy rates and poorest health statistics in the region. USAID's education and health projects have partnered with the United Nations (UN) to improve education and health care for future generations through improving the quality of teaching and the learning environment for schoolchildren and improving the capacity of the Ministry of Health to provide quality essential services nationwide, including vaccinations against infectious diseases such as measles, mumps, rubella, and polio.

Our Commitment to Accountability

USAID remains committed to ensuring that the resources provided by Congress are managed effectively and transparently. Ensuring that these funds are utilized in such a manner only strengthens their impact and improves the chances for success in Iraq. Accountability for Iraq funds is greatly enhanced by the right mix of experienced staff, teamwork, and coordination between agencies. Experienced controllers, contracting officers, and Inspector General staff have been in Iraq since 2003 working with program technical staff, other agency colleagues, and Iraqi counterparts to help ensure program accountability.

We have welcomed and supported the work of the Special Inspector General for Iraq (SIGIR), with whom we work closely. We also work openly and fully with the U.S. Government Accountability Office (GAO).

Accountability starts with a fair and open procurement process. USAID complies with all applicable federal regulations and works closely with our Office of the Inspector General (OIG) to identify and address any weaknesses. USAID's accounting and procurement systems ensure that the responsibility for procurement authorizations, justifications, and payments are segregated and recorded. A summary audit report on the contract award process found that USAID has generally complied with applicable regulations. Along these lines, a recent GAO report entitled *Status of Competition for Iraq Reconstruction Contracts* stated that "based on complete data for [October 1, 2003 through March 31, 2006] we found that USAID competitively awarded contract actions

for 99 percent of its obligations." In other words, USAID competitively awarded $2.25 billion of the approximately $2.27 billion in IRRF II we obligated. We are extremely proud of this fact.

The President's Management Agenda shows USAID with "green light" progress on improvements in financial management. The Iraq Budget and Finance Team received the Administrator's 2005 Management Improvement Award for innovative financial information tracking.

USAID's on-the-ground presence is critical to project oversight. Well-trained, on-site contracting staff and project managers use informed judgment to oversee USAID projects. USAID's project managers are trained through a certification program in acquisition management practices. These personnel, located in Baghdad, regional offices, and Washington, provide the technical oversight of our programs. Throughout this year, USAID personnel have averaged 14 project site visits per week. Our colleagues in the U.S. military have been forthcoming in providing not only security support for our staff, but also assistance in monitoring USAID projects in those areas deemed to be insecure. USAID has also taken proactive measures, such as fraud awareness training for government employees, contractors, and grantees, to reduce the likelihood of undetected fraud, waste, or abuse of funds. OIG audit staff in Baghdad conduct performance audits of USAID programs on a regular basis and often concurrently to enable USAID to identify problem areas early on.

USAID firmly believes that the USG must ensure that its IRRF investments in Iraq are formally accounted, operated, and sustained by the GOI. To this end, USAID participated in an IRMO-led interagency process to develop uniform procedures for the formal transfer and recognition of USG-funded capital assets to the Iraqi Government.

In conclusion, I want to assure you that USAID is taking every measure it can to ensure that U.S. Government resources and are used effectively and transparently. The successes that have been achieved to date in Iraq are the tangible results of these efforts. I believe that with Congress' continued support, USAID will be able to make further strides in helping to achieve success in Iraq.

Mr. Chairman, thank you for offering me this opportunity to discuss USAID's role in Iraq with your Committee. I am prepared to answer any questions the Committee may wish to pose. Thank you.

Chairman TOM DAVIS. Thank you very much.

Ms. Ballard, thanks for being with us.

STATEMENT OF TINA BALLARD

Ms. BALLARD. Good morning. Thank you, Chairman Davis, Congressman Waxman, and distinguished members of the Committee on Government Reform, for this opportunity to report to you on the U.S. Army's reconstruction contracting efforts in Iraq.

It is my privilege to represent the Army leadership and the military and civilian members of the combined reconstruction program management and contracting work force team. We appreciate your wisdom, advice and steadfast support. The Army is the executive agent for the Department of Defense reconstruction and relief mission in Iraq, as outlined in the IRRF, and is responsible for the execution of approximately $13 billion of the $18.4 billion appropriated by Congress for projects in Iraq.

In January 2005, with the cooperation and leadership of the U.S. Central Command, the Joint Contracting Command-Iraq and Afghanistan [JCCIA], was established. This Joint Command, which is headed by a two-star general, operates under the Army's acquisition authority and has more than 160 people in two theaters of war who are working in dangerous and difficult conditions.

The JCCIA operates in full compliance with Federal acquisition regulations and to date we have awarded more than 4,000 contracts for the reconstruction of Iraq. We do this mission with great pride and gratitude to Congress, the Army team and our interagency partners, the Department of State and U.S. Agency for International Development. This team has proven to be resourceful and resilient, while adjusting to every challenge presented by the evolving conditions in Iraq.

I want to emphasize the following important point in particular. The reconstruction program in Iraq has been one of the most audited efforts ever undertaken by our Government. From the beginning, we have welcomed this good government look at our work. Our policy throughout this mission has been to work side by side with every auditor in order to ensure the proper expenditure and oversight of money allocated by the Congress.

We have also found that the auditors serve a valuable role in helping us execute our mission. While the challenges have been daunting at times, we have maintained a tremendous sense of urgency and intense operational tempo with regard to our reconstruction mission.

In summary, we are an Army at war. We are proud of our accomplishments and we want the people of this great Nation and you, the Members of Congress who represent them, to know of this great effort in helping to create and build a stable and successful Iraq. With your continued support, we will succeed.

This concludes my opening statement, Mr. Chairman. Again, I thank this committee for its continuing wisdom, guidance and steadfast support. I look forward to your questions.

[The prepared statement of Ms. Ballard follows:]

RECORD VERSION

STATEMENT BY

MS. TINA BALLARD
DEPUTY ASSISTANT SECRETARY OF THE ARMY
(POLICY AND PROCUREMENT)

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

SECOND SESSION, 109TH CONGRESS

ON THE RECONSTRUCTION EFFORTS IN IRAQ

SEPTEMBER 28, 2006

NOT FOR PUBLICATION
UNTIL RELEASED
BY THE COMMITTEE
ON GOVERNMENT REFORM

INTRODUCTION

Thank you for this opportunity to report to you on the reconstruction efforts in Iraq with respect to our responsibilities for approximately $13 billion of the Fiscal Year 2004 funding appropriated for Iraq under the Iraq Relief and Reconstruction Fund (IRRF). It is my privilege to represent the Army leadership and the military and civilian members of the combined reconstruction program management and contracting workforce team.

HISTORY

The Army has been the Executive Agent for the Department of Defense (DoD) reconstruction and relief mission in Iraq as outlined in the IRRF and has been responsible for the execution of approximately $13 billion of the $18.4 billion appropriated by Congress for projects in Iraq. The following is a brief history of this monumental effort.

Responsibility for providing humanitarian assistance and aiding in the reconstruction of post-war Iraq initially fell to the Office of Reconstruction and Humanitarian Assistance (ORHA), which was tied to both DoD and the U.S. Agency of International Development (USAID). Later, the Coalition Provisional Authority (CPA) was established and responsibility for the reconstruction was shifted to that organization. The CPA, which existed from May 2003 to June 2004, was originally charged only with responsibility for the oversight and expenditure of the Development Fund for Iraq and the initial funds appropriated in April 2003 under the first emergency supplemental for Iraq – most of which was provided to USAID to support immediate reconstruction requirements. However, with the appropriation of the $18.4 billion into the IRRF, under P.L. 108-106 in November 2003, the CPA's reconstruction mission expanded.

In January 2004, the Program Management Office (PMO) was established by and within CPA to provide programmatic support for the IRRF. It was at this same time that the Army was asked to expand its Executive Agency responsibilities to specifically include acquisition and program management

support. In February 2004, a one-star General Officer was designated as the Head of Contracting Activity (HCA) for Iraq reconstruction, and the contracting mission was expanded in staffing and scope. In fact, during this initial reconstruction phase when there was less than optimal information on reconstruction requirements, the Army awarded $6.1 billion in Indefinite Delivery-Indefinite Quantity Design-Build construction contracts to seven separate contractors. This took only 90 days with full and open competition and in full compliance with the Federal Acquisition Regulation (FAR). Furthermore, there were no contract protests. Normally, this process would have taken nearly 18 months.

The next phase of the Army's acquisition and program management responsibilities in Iraq occurred in June 2004, upon the stand-down of the CPA and the establishment of the U.S. Embassy for Iraq. The Department of State (DOS) assumed overall control of the reconstruction program through the Iraq Reconstruction Management Office (IRMO). IRMO was given the responsibility of managing all assistance efforts in Iraq, coordinating all U.S. efforts, and setting the priorities and requirements for the use of all IRRF funds. The Army, USAID, State, Treasury, and the U.S. Institute of Peace, served as the implementers of DoS's priorities for reconstruction. In preparation for this transition, the Project and Contracting Office (PCO) was established to replace the PMO and moved under the direct supervision of the Assistant Secretary of the Army (Acquisition, Logistics and Technology) (ASA(ALT)). In Iraq, PCO was placed under Chief of Mission authority, with IRMO acting as the designated entity supervising IRRF programs. A Principal Deputy was added to the Office of the ASA(ALT) to direct efforts with the PCO as the Director of Iraq Reconstruction and Program Management. Additionally, I worked to improve oversight of the contracting mission by establishing the Office of the Deputy Assistant Secretary of the Army for Policy and Procurement – Iraq, or DASA (P&P)-Iraq. The PCO-Washington and the DASA (P&P)-Iraq offices are co-located and work together to bring full cooperative reach-back support to the program and contracting personnel on the ground in Iraq.

In October 2004, the U.S. Central Command designated the Army as the lead component for contracting for Operation Enduring Freedom in the Combined Joint Operations Area, Iraq and Afghanistan, and the Joint Contracting Command-Iraq/Afghanistan (JCC-I/A) was established. JCC-I/A provides contracting support under the authority of the ASA(ALT) as the Army Acquisition Executive (AAE) to both the Iraq reconstruction effort and to our combatant commanders in Iraq and Afghanistan. The JCC-I/A is headed by a two-star General Officer who has been designated by the AAE as HCA for Iraq and Afghanistan. This joint command has more than 160 people in two theatres of war who are working in dangerous and difficult conditions.

We are now in another phase of the Army's mission to support the reconstruction. As the majority of our projects moved from design to construction, we responded to this development by asking the U.S. Army Corps of Engineers, Gulf Region Division (GRD), to expand its responsibilities for on-the-ground construction management, and they have responded magnificently. PCO has consolidated and streamlined its organization in association with the GRD in order to increase efficiencies and continue efforts to reduce costs and complete the mission. As of December 4, 2005, the PCO Director in Iraq became the GRD commander. This three-stage evolution from the CPA and PMO, to the PCO, and currently to GRD/PCO and JCC-I/A is truly a good news story that demonstrates how effectively the Army can organizationally readjust and respond to the changing circumstances in a war-time environment and, at the same time, provide consistent policy guidance and oversight.

CURRENT PERFORMANCE

At the end of this month, the IRRF will expire and we will mark a milestone in our efforts to support the Iraqi people's aspiration to create a vibrant economy that provides essential services to the population. We do so with great pride and with gratitude to Congress, the Army team, and our interagency partners – the DoS and USAID – as well as the Government of Iraq and the many Iraqi firms

with which we work. Throughout the IRRF program, this team has proven to be resourceful and resilient, while adjusting to every challenge presented by the evolving conditions in Iraq. The team has operated in full compliance with Federal Acquisition Regulations.

The accomplishments have been many, including:

- More than 3,100 projects completed;
- Increased power generation benefiting 1.3 million homes;
- New grade schools serving 325,000 students';
- 250 border forts that help secure more than 2,000 miles of Iraq's borders; and
- New and restored water treatment facilities that benefit approximately 1.9 million citizens of Iraq.

To facilitate the sustainable operations of our reconstruction projects, our contractors are required to transfer their technical knowledge and skills to Iraqi personnel. This is accomplished through thousands of training hours and the provision of contract deliverables, including operations and maintenance manuals, preventative maintenance plans, and databases that contain information on both subcontracting activities and efforts to develop the capacity needed to sustain the infrastructure being built.

The success that we see on the ground in-theater by IRMO, the GRD/PCO, and JCC-I/A is being achieved with a dedicated group of military, civilian and contractor personnel. Both offices operate long hours, seven days a week under extremely volatile conditions. On January 29, 2005, we lost two of our own – Barbara Heald and Navy Lieutenant Commander Keith Taylor – who were killed at their desks by a rocket attack on the U.S. Embassy compound in Baghdad. These are the heroes and the role models for all working this important mission to support democracy.

ACCOUNTABILITY

I also want to emphasize the following very important point. The reconstruction program in Iraq has been one of most thoroughly audited efforts ever undertaken by our government. From the beginning, we have welcomed this "good government" look at our work. In addition to the Special Inspector General for Iraq Reconstruction (SIGIR), we also have been audited by the Government Accountability Office (GAO), the Defense Contracting Audit Agency (DCAA), the Department of Defense Inspector General (DODIG), and the Army Audit Agency (AAA). Our policy throughout this mission has been to work side-by-side with all auditors in order to ensure the proper expenditure and oversight of American taxpayer money allocated by the Congress. We have also found that they serve a valuable role in helping us execute our mission better and with greater care. Let me also assure you that we have worked continuously to uphold all U. S. laws and regulations, and that, as stated previously, all contracts are awarded in complete conformance with the Federal Acquisition Regulations.

CONCLUSION

While the challenges have been daunting at times, we have maintained a tremendous sense of urgency and intense operational tempo with regard to our reconstruction mission. We are proud of our accomplishments, and we want the people of this great nation and the Members of Congress who represent them to know of this great effort.

In summary, we are an Army at war, a full member of the Joint and Interagency Team. We are fighting and winning the Global War on Terrorism while bearing the enormous responsibilities associated with reconstruction. We are proud of our role in helping to create and build a stable and successful Iraq. With your continued support, we will succeed.

Chairman TOM DAVIS. Tina, thank you very much.

Mr. Tyler, thank you for being with us.

STATEMENT OF J. JOSEPH TYLER

Mr. TYLER. Mr. Chairman, Ranking Member Waxman, and members of the committee, thank you for the opportunity to discuss the successes and some of the challenges the U.S. Army Corps of Engineers and the team we work with has experienced in execution of the reconstruction program in Iraq.

I have had the pleasure of having oversight management for this program from the time it originally started. I would like to emphasize a few points included in my written statement.

First, the Corps of Engineers is committed to supporting the Nation's global war on terror. We have supported the operation in Iraq from the very beginning. Our entire work force of 34,000 personnel has been available to support the effort. About 3,300 personnel from both our civil works and military mission areas have volunteered for deployment, many for multiple deployments. The remaining personnel that stay here in the States are often used for reach-back support of our personnel on the ground in-theater.

Our multi-talented expeditionary work force has allowed us to respond positively to this reconstruction mission. Our current work force in Iraq consists of military personnel, U.S. Government civilians, DOD contractors, and Iraqi associates. We utilize these personnel in various capacities to allow us to execute our mission in the most efficient and effective manner. We will use the Iraqi associates in insecure areas which would endanger U.S. personnel or draw unwanted attention to the reconstruction effort. It is because the Iraqi associates are able to move more freely throughout their country.

Now, beginning in October 2005, the Corps' office in Iraq, our Gulf Region Division [GRD], and its three district offices, began a gradual evolution toward consolidation with the Project and Contracting Office [PCO]. This consolidation commenced as reconstruction projects moved from the planning and design stage of execution to the construction stage. GRD has always supported PCO in construction oversight. Therefore, it made sense from a cost and program execution perspective to streamline our personnel and processes by consolidating the offices and focusing on completing program construction. This consolidation will be complete next month.

Overall, the Corps has been successful in oversight management and execution of its reconstruction mission. We have completed construction on 3,100 quality projects at a cost of about $4 billion. There are slightly over 800 projects under construction right now, and there are over 500 projects that are anticipated to start construction in the next few months.

This success was not without challenge. Construction quality is always a challenge, even in the United States. The challenge is amplified by the Iraqi environment. Our personnel and our contractors, United States and Iraqi alike, are constantly challenged in the day-to-day operations. In spite of that challenge, we are able to deliver quality facilities for the Iraqi people.

There are always the exceptions that rise to the surface in getting significant scrutiny. These exceptions also demand our intensive management, and often extraordinary actions to achieve the appropriate remedy and the quality results.

Mr. Chairman, this concludes my opening remarks. Again, I thank you for the opportunity to discuss the Corps' reconstruction efforts in Iraq.

[The prepared statement of Mr. Tyler follows:]

RECORD VERSION

STATEMENT BY

MR. J. JOSEPH TYLER
ACTING DEPUTY DIRECTOR OF MILITARY PROGRAMS,
U.S. ARMY CORPS OF ENGINEERS

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

ON THE RECONSTRUCTION EFFORTS IN IRAQ

SECOND SESSION, 109TH CONGRESS

SEPTEMBER 28, 2006

NOT FOR PUBLICATION
UNTIL RELEASED BY THE
COMMITTEE ON GOVERNMENT REFORM

Mr. Chairman and Members of the Committee, good morning. I am J. Joseph Tyler, Acting Deputy Director of Military Programs, U. S. Army Corps of Engineers. Military Programs provides oversight and reach-back support to the Gulf Region Division for all USACE activities in Iraq. It is an honor to address you today.

Support to this country's Global war on Terror continues to be the Corps of Engineers number one priority. To date, the Corps has had approximately 3300 personnel deployments in support of the Global War on Terror with many people volunteering for more than one deployment. These deployments range from 120 days to a year or more. Primarily civilian volunteers, these men and women work in Iraq, Afghanistan and Kuwait in support of the reconstruction effort.

The successful deployment of civilians to Iraq has shown that USACE peace-time training, Civil Works and Military Programs missions and our response to natural disasters has prepared the civilian workforce to support a contingency operation in a military environment. Although only about 10% of our civilian employees have actually deployed, many others have assumed the responsibilities of their deployed co-workers or have provided direct support through our reach-back efforts. This reach-back program allows us to utilize the experience and knowledge of our 34,000 civilian employees virtually, expanding our capabilities and making our expertise available to the operation while reducing the number of personnel in harms way.

The Gulf Region Division (GRD) Office, and three District Offices located in Tikrit, Baghdad, and Tallil are currently assigned 494 US personnel and 473 local nationals for a total of 967 personnel.

Corps employees have filled vital positions in the Program Management Office (PMO)/Project and Contracting Office (PCO) from its inception in the Fall of 2003. When GRD stood up in January 2004, we teamed with PMO/PCO to become their

Construction Manager. Then recently, when the majority of effort shifted from programming and planning to construction management, GRD and PCO merged into a single organization that will officially commence operations on 1 October 2006.

Together over the past three years PCO and GRD have completed 3,106 construction projects at a cost of roughly 4.1 billion dollars out of a total planned program of 4,463 projects estimated to cost almost 8.5 billion dollars. There are 817 projects currently under construction leaving approximately 534 projects that will be started within the next few months. The types of projects range from small relatively simple renovations to large complex construction programs.

To date, these projects have delivered 11 refurbished hospitals that can serve a total of 6,300 patients a day, provided water treatment capacity that can serve 1.5 million Iraqis, added, rehabilitated or maintained over 1,420 Megawatts to the power grid, increased crude oil production capacity by 300,000 barrels per day, and provided 320,000 grade school students with improved schools.

The Corp's quality assurance program is designed to oversee the contractor's quality control program. Project and field office staffing varies based on the complexity of the project and the project funding available to pay for the Corp's services. The dangerous environment in Iraq makes it extremely difficult for GRD to provide quality assurance and project oversight on all projects at all times, and certainly not at the same level as we would in a secure environment.

One Project Engineer traveling outside secure areas requires a security team. The trade-off for spending more time on each project is higher security costs. The challenge is to provide acceptable quality and oversight while minimizing the dollars spent on security. Every dollar spent on security is one less dollar available for reconstruction. Additionally an American engineer traveling with a large security team

lets everyone know that the project is being built by the Americans. This puts the contractor and the facility at risk. These risks are further magnified if the prime contractor is an American contractor. Contractors and subcontractors face intimidation and violence on a daily basis.

We have successfully developed processes and methods to mitigate security risks while still providing quality assurance services. One method is hiring and training Iraqis to visit the construction sites and report back with their observations. They take pictures and notes which can be reviewed by the USACE expert in the secure area. This reduces costs and our security footprint while providing acceptable construction results, training Iraqis and accomplishing capacity building.

The majority of our projects have been completed successfully with good quality. Some have been more challenging than others but we strive to work past the challenges and provide quality finished products.

The contract with Parsons Global Services to build 142 Primary Health Care facilities (PHC) is one example of a challenging project. Parson's contracted to complete 142 PHCs located throughout the country. The contract funds were being exhausted at a faster rate than construction placement was occurring. Parsons was incurring costs even though actual work on the PHCs was sporadic. They had to deal with an environment where their Iraqi subcontractors were being killed or their family members threatened. It was extremely difficult to get the subcontractors to work consistently.

GRD and Parsons met on several occasions to determine how to complete the work within the budget and schedule. PCO and GRD attempted to "cure" the situation involving senior leadership from both the Government and Parsons. Unfortunately Parsons was unable to complete the work within the budget and schedule. It was

determined that under the circumstances the best course of action was to terminate Parson's contract on all but 20 PHCs and to honor the U.S. Government's commitment by pursuing other means to complete the remaining PHCs. Although Parsons is ultimately only responsible to complete 20 PHCs most of the remaining PHCs were at some degree of completion. Working with the State Department, contracts were issued to complete the remaining 122 PHCs.

At this time all 142 PHCs are either completed or under contract. 122 of the PHCs are contracted directly to local firms using firm fixed price contracts. The total cost will exceed the original budget but will be far less than if we continued with the original contract. Contracting directly with the Iraqi firms is far more cost affective due to the fact that they are able to execute the contract more efficiently in the perilous environment with lower overhead.

Initially in 2004 the large cost plus contracts were viewed as the best course of action given the situation on the ground and scope of the work that needed to be done. As the situation evolved, and it became evident that more Iraqi firms were able to compete and work as prime contractors, the U.S. Government began to shift resources directly to these local firms. The Joint Contracting Command – Iraq and GRD have been contracting directly with local firms on projects for some time now. We continue to provide construction oversight on these contracts. Iraqi firms attract less attention and over all are able to provide quality and timely construction at much less cost.

Our program is yielding positive, tangible results every day while significantly improving the lives of the Iraqi people by adding infrastructure improvements and increasing local capacity. Certainly, the work in Iraq is challenging and difficult, but reconstruction efforts are a vital component to Iraq's progress toward democracy. Currently the Gulf Region Division is integrally involved with Operation Together Forward

in order to improve the essential services and quality of life for Iraqis living in Baghdad. This combined endeavor between the Iraqi police, the Iraqi army and the Multinational Division-Baghdad, seeks to reduce violence in Baghdad and reinforce the government's control of the city.

Reconstruction Liaison Teams are deployed to neighborhoods identified by the Joint Operations Center as being "priority areas" and are assessing projects that will improve the quality of life in the communities -- short-term projects such as trash removal; and long-term projects such as sewage, water and electricity.

This month GRD and JCC-I will complete the obligation of the last of the Iraq Relief and Reconstruction Funds. We anticipate the GRD program in FY 2007 will exceed $2B in the execution of reconstruction contracts awarded before September 30, 2006. The GRD organization will be tailored, as it has been since its inception, to meet the needs of the program and funding provided. We will continue to rely on volunteers willing to step into harms way in Iraq on this important mission.

Mr. Chairman, The U.S. Army Corps of Engineers stands ready to continue support for the Global War on Terror and I would be happy to answer any questions you may have.

Chairman TOM DAVIS. Thank you.

Let me start. Ambassador Satterfield, let me just ask you, in terms of electrical power, does Iraq have more power or less power today than when we came in?

Mr. SATTERFIELD. It has more power, Mr. Chairman, significantly more power. There are limitations to the amount that can be physically transmitted on Iraq's infrastructure, but within that limitation, we are contributing as a result of our projects, our efforts and our money, over one-third of the delivered transmitted power today to Iraq's citizens.

Chairman TOM DAVIS. OK. Is there still a lot of sabotage of that going on?

Mr. SATTERFIELD. There is significant sabotage. If you look nationally at electrical power, its operations and maintenance deficiencies, fueling problems, that is delivering the right kind of fuel to the right plants on time, that is the biggest contributor, rather than sabotage. But if you look at Baghdad as a signal piece of that puzzle, the amount of damage or deficiencies due to sabotage is about one-third of the total power.

Chairman TOM DAVIS. And Baghdad got the bulk of the power under the previous regime.

Mr. SATTERFIELD. Under the Saddam regime, Mr. Chairman, Baghdad deliberately received the bulk of the power for political reasons. The rest of the Nation was starved.

Chairman TOM DAVIS. Thank you.

Mr. Bowen, let me ask, you just released a report on the shoddy construction of the Baghdad Police College that is all over the headlines today. Obviously, this lax contract oversight didn't perform. It just has to be unacceptable. What were the prime contractor's reaction when these defects were pointed out? And how did we get to this?

Mr. BOWEN. It is a good question. It boils down to a lack of oversight, both on the scene by——

Chairman TOM DAVIS. But even with oversight, the contractor should have, I mean——

Mr. BOWEN. You're right. The way this happened, it is subcontracting. You understand this. Parsons got the design-build contract for facilities in March 2004, a $500 million IDIQ. Included in that were the health care and also other facilities, including the Baghdad Police College. It is a $73 million project. The work is done through subcontracting.

Chairman TOM DAVIS. Let me ask, we do encourage them to hire Iraqis for this. Isn't that part of the policy?

Mr. BOWEN. That is exactly right. It is incumbent upon them to hire Iraqi firms that are competent, and there are many. We talked about the fact that many of our projects that we have seen have been successful and they have been performed by Iraqi firms. So that is not the dispositive issue. It is what happened at the Baghdad Police College that is determinative.

But in constructing there, there were all manner of shortfalls. They used the wrong pipes. They didn't have fittings. They just cut pipes, cemented them together, and then finished the floor. Of course, they burst, and that was in all barracks. There is a half-completed laundry facility that $300,000 was invested in that has

to be torn down. They are not going to finish it. There is another facility next to it, same story. There is a beautiful classroom building out just beyond that laundry facility that has no power.

Chairman TOM DAVIS. If this were out in Fairfax or in Los Angeles, you would have building inspectors looking at all of this. Do they not have that regime in place there?

Mr. BOWEN. They did not. The Deputy Commander of GRD went out there with me a week ago. I addressed this exact issue, that you are pointing to. He was unaware of what the oversight situation was from the GRD perspective before the turn of this year. And so, that is something that we continue to drill down on. This was a quick reaction report to draw attention to it, to get the resources there to fix it now, because we are scheduled to turn this over at the end of the year.

Chairman TOM DAVIS. What is the contractor's responsibility in something like this? Ultimately, they are building it. If you don't have a government regime doing the inspections, then they need to do it, and it sounds like that wasn't done.

Mr. BOWEN. You are exactly right. It is a multi-layered oversight process and that is the case for every project in Iraq. Parsons had a duty to supervise how this Iraqi firm was doing. In other words, get a look at exactly what they were planning on doing with that plumbing and not to let it all get laid and then burst and be a disaster.

Chairman TOM DAVIS. I guess our problem is, I mean, you can look at one project, but when something can go this badly, and if anything could go wrong, it did go wrong here, and you can point back and forth, but the concern that I have, and I think Mr. Waxman and other Members have is, is this systemic? How many other projects like this are going on?

Mr. BOWEN. I am glad you asked that. I have a list here of the 14 Parsons projects that our inspectors have visited; 13 of them don't meet standards. Ironically, the one that does meet standards, the Nasiriyah Prison project that I visited in May, was terminated for default for other reasons, primarily for the issues I saw then. It was de-scoped from serving 4,400 prisoners to 800, and the cost was 50 percent more. But I was there and I saw the construction at that facility is of quality service, but the forward border post at Sulaymaniyah, it was a design flaw in the center beam that our engineers, actually my inspectors are an engineer and an auditor, the engineer picked up on it and adjusted the design. The Allaminon primary care facility, the five PHCs we visited, all——

Chairman TOM DAVIS. My last question, I get you, but are these taxpayer funds or are these Iraqi funds that were paying?

Mr. BOWEN. Taxpayer funds. These are IRRF projects.

Chairman TOM DAVIS. Mr. Waxman.

Mr. WAXMAN. Mr. Bowen, did Parsons get paid?

Mr. BOWEN. Yes.

Mr. WAXMAN. Are they going to pay any of this money back?

Mr. BOWEN. No. The structure of contracting, cost-plus, means that the U.S. Government bears the burden, so to speak, of paying for what happens in the course of performing that contract. That means if a subcontractor fails, and you have to move on to some-

body else, that cost is borne. That happened up in Urbeyo, the water treatment plant I visited last November. Same story.

Mr. WAXMAN. Well, let me interrupt you. You issued this report that just came out about this Baghdad Police College. I have some photos of the police college that I am going to ask be available. You said our job in Iraq is to provide help for their economy and their security. What could be a more important symbol than giving them the ability to have police trained for security and buildings that will give them a boost to their economy? What you found in your report is truly disgusting. The photos don't really even capture it all. It is a civil security project in the country that is a failure. It is the Baghdad Police Academy and it is a disaster.

I went through some of the points earlier in my opening statement about fecal matter and urine going right through the building. It is not a very proud symbol for the U.S. efforts in Iraq, is it?

Mr. BOWEN. As I said, the plumbing design and execution was extremely poor. As a result, it failed once it came into use.

Mr. WAXMAN. Well, the chairman asked you this. Who is responsible for this disaster? Is it Parsons? Is it the Army Corps of Engineers? Or is it both?

Mr. BOWEN. I think it is a shared responsibility.

Mr. WAXMAN. And is this the first project that Parsons and the Corps of Engineers bungled?

Mr. BOWEN. This is the most problematic project that we have visited.

Mr. WAXMAN. But is it the first?

Mr. BOWEN. As I said, we have visited 14 Parsons projects, four border forts up in Sulaymaniyah, five PHCs in the Tamime area. Total value of the projects we have looked at is $136 million, and I wouldn't use the word "bungled," but I would say that they have not met the contract's expectations.

Mr. WAXMAN. As I indicated, this is perhaps the new symbol of the Bush administration's failure, the dilapidated and disgusting facilities of the Baghdad Police College. We spent $75 million of taxpayers' money on it. I am trying to figure out how we got to this point. You have indicated you thought it is a failure of oversight.

Well, the Washington Post reported in 2003 and 2004, a Defense Department political appointee named Jim O'Beirne directed and organized a systemic screening process to hire Republican loyalists for the key Provisional Coalition Authority. Mr. O'Beirne was the Pentagon's liaison to the White House. Mr. O'Beirne's office posed blunt questions about the political leanings of CPA applicants. People who were supposed to work on overseeing these kinds of projects for this provisional government that we were in charge of were asked questions about whether they voted for George Bush in 2000, and even their views on abortion.

To recruit the people he wanted, O'Beirne sought resumes from the offices of Republican Congressmen, conservative think-tanks, and GOP activists. He discarded applications from those through his staff that were considered ideologically suspect, even if the applicant's possessed Arabic language skills or post-war rebuilding experience.

Ambassador Satterfield, is this true? Was the Pentagon's White House liaison screening people to run Iraq on the basis of how Republican they were?

Mr. SATTERFIELD. Congressman, I cannot comment on the CPA period. What I can comment on, though, is the extraordinary professionalism, dedication and qualifications of the staff at our mission in Iraq, in Baghdad and elsewhere, working on these development issues today and over the course of the past years.

Mr. WAXMAN. But so much of what we are talking about, including this police academy, was handled during the CPA period. There was one specific example of this cronyism in the health sector. There was Dr. Frederick Berkel, Jr. He was removed as the head of Iraq's health care system 1 week after the fall of Baghdad because, as I understand it, the White House wanted a loyalist. My staff talked to Dr. Berkel. And the e-mail he received informed him that he was removed purely on politics.

Mr. Bever, you are USAID, can you tell us whether Dr. Berkel was removed from his position based on politics? Did USAID believe he was not qualified?

Mr. BEVER. I am not qualified to answer that particular question. I have not seen that e-mail, sir. We can get a question for the record if you would like.

Chairman TOM DAVIS. We will put that on the record.

Mr. WAXMAN. Thank you.

Chairman TOM DAVIS. Mr. McHugh.

Mr. MCHUGH. Thank you, Mr. Chairman.

Obviously, the conditions at the extreme are unacceptable, the hemorrhaging of taxpayers' money is despicable, and I would hope we would all want to see it stopped. That is why we are here, in large measure, I would hope.

Mr. Bowen, you mentioned the configuration of the contract as cost-plus. What is the reason for that configuration?

Mr. BOWEN. Because of the risks that contractors must bear when going to a place like Iraq, about which requirements are limited or unknown.

Mr. MCHUGH. Would it be your considered judgment, that is an absolutely essential component of any contract to be successfully let? Or is that just something we have allowed ourselves to slide into?

Mr. BOWEN. No, absolutely. It is an essential tool in performing construction contracts in contingent environments. I am not arguing for the abolition of cost-plus. I am just arguing for a review of it to see how it can be better tuned to meet the needs in contingent environments.

Mr. MCHUGH. Which leads me to my next question. Why is it not possible, and this is not strictly in your lane, I understand, but you have been there. Your folks have been there. You understand the conditions. Why would it not be possible, even with the security situation, and I have been there six times, and I understand, not to have some codicil in the contract structure that requires a minimum amount of applicable oversight? It sounds to me as though Parsons was out at the oasis somewhere.

Mr. BOWEN. That is a significant point. The fact is that the oversight is expected and part of the contracting process. There are con-

trols in the system that needed to be exercised that didn't. For example, as one of our audits this last quarter underscored with respect to DOD IDIQ contracts, the need for definitization was viewed as voluntary, and that was inaccurate as the General Counsel to the Army observed in a June opinion.

The lack of that discipline within the cost-plus contract system created leeway for waste.

Mr. MCHUGH. Do you think there was a cause of action against Parsons?

Mr. BOWEN. Let me put it this way, I have been an advocate for terminations for default whenever the Commander of JCCIA and I sees it as appropriate.

Mr. MCHUGH. Let me state, I do. I think, for the record, for whatever that is worth, based on what I know, and maybe I could learn more that would convince me otherwise, but it seems to me, as I believe I heard you say, out of 14 Parsons contracts, 13 you found to be unacceptable.

Mr. BOWEN. The construction at the border posts and at the PHCs that we visited, the Primary Healthcare Clinics, was substandard, did not meet contract expectations.

Mr. MCHUGH. And 13 of 14, was that the figure?

Mr. BOWEN. Yes. And the 14th was the Nasiriyah Prison, which was ironically terminated for default.

Mr. MCHUGH. So when they get the construction right, something else goes wrong?

Mr. BOWEN. That is right. I think the reason was that the scope was reduced from 4,400 to 800, without the cost being similarly reduced.

Mr. MCHUGH. Thank you.

I would turn to Ms. Schinasi. You spoke about the fundamental lack of oversight being, in your judgment, the No. 1 reason why we have the conditions we are talking about here today. Did I hear you correctly? I would be curious if you are able to evaluate the reason for that lack of oversight. In other words, is it a resourcing problem from your judgment? Or is it just a matter of lack of attention? Can you quantify that?

Ms. SCHINASI. I think it started out as a resource issue. I mentioned the whole design-build construct, which is the management structure under which a lot of these projects got started. In that project management structure, we relied very heavily on contractors to manage contractors. That was in part a decision made for resource reasons.

Mr. MCHUGH. OK. I just have a few seconds left. My friend from California, in his opening statement, talked about what he described, I am sure he is absolutely correct, 15 years ago, a very painful experience in oversight that he went through talking about cronyism and corruption, two of the words he used, at the highest levels of the Department of Housing and Urban Development. In either of your two experiences, Mr. Bowen or Ms. Schinasi, have you seen any indications that there is corruption that would be found in the higher levels of the agencies involved in these projects?

Ms. SCHINASI. That is not an issue we have addressed.

Mr. MCHUGH. Sir?

Mr. BOWEN. No. As I have said before, corruption is not and has not been a pervasive component of the U.S. reconstruction program in Iraq.

Mr. MCHUGH. Thank you.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you.

Mr. Lantos.

Mr. LANTOS. Thank you very much, Mr. Chairman.

In reading all of these reports and all of this testimony, one is confronted with a new language. It is sort of sanitized bureaucratese, not English. So what I would like to ask each member of the panel briefly is if you would be pretending that you are in a living room talking to ordinary people, who don't enjoy reading bureaucratese. How would you evaluate and characterize the oversight and the accomplishments in this field which has cost the American taxpayer $30 billion. We will begin with you.

Ms. Schinasi. Yes, if I can back up from the oversight question, I think where I would like to start answering that question, is looking at the task we set out for ourselves and understanding up front what that task was going to cost, and making sure that we had the resources to assign to it, because without understanding what you are able to accomplish, we put projects in place that perhaps were not executable, particularly when you look across the country as a whole.

So the oversight needs to come in to make adjustments to those initial assumptions that proved faulty, and that oversight has not been there. We have not been able to make adjustments, and so we are at a point now where I think we have to step back and look at what is it that we can do, and then how are we going to accomplish that with the reconstruction projects that are already on the books.

Mr. LANTOS. What you are saying is that initially lots of projects were proposed and approved, and according to the Inspector General, paid for, which were not feasible to begin with and never completed. Let me zero in on the primary healthcare center issue, because quite frankly it simply makes no sense what you are telling us, Mr. Inspector General. You say this project began in March 2004, with a contract for 150 centers. Is that correct?

Mr. BOWEN. That is correct.

Mr. LANTOS. And only six were accepted as completed by the U.S. Army Corps of Engineers 2 years later.

Mr. BOWEN. That is right.

Mr. LANTOS. Well, this failure ratio is a Guinness World Book of Records answer. I mean, if you have 150 healthcare centers that are planned, funded, construction begun, and 2 years later you find that only 6 are completed, this requires an explanation.

Mr. BOWEN. Mr. Lantos, your core point is correct. The primary healthcare program in my view is the most significant failure in the overall reconstruction program.

Mr. LANTOS. This was a Parsons project?

Mr. BOWEN. That is right.

Mr. LANTOS. Parsons has a lot of experience. They have completed many projects globally over many years. How is it feasible, explain it to us in very simple terms, that Parsons undertakes a

project involving 150 health centers, and 2 years later 6 are completed, the contracts are terminated, although we paid Parsons. They walk away with the money for 144 that were not completed. Explain this to me as a taxpayer.

Mr. BOWEN. I would be happy to. The number of clinics was descoped to 141, reduced to that number.

Mr. LANTOS. "De-scoped" means? Let's use English.

Mr. BOWEN. Right.

Mr. LANTOS. I don't know what "de-scoped" is. We started with 150 and then we moved it down to 141.

Mr. BOWEN. To 141, you are right. I am sorry.

Mr. LANTOS. That is English.

Mr. BOWEN. I will speak in clearer terms. The six were completed.

Mr. LANTOS. Which means 135 were not?

Mr. BOWEN. That is correct. Parsons agreed to finish 20 of those clinics that were nearly complete, of which those 6 that are complete are part of it. So that is down to 125. A couple of clinics were handled by other direct contracting. But here is the point, of the balance 122 clinics left in the number that I am talking about, they are all either halfway or more completed, 50 percent, 75 percent, 90 percent. What the Corps of Engineers has done is picked up this mess and developed a plan to solve it by contracting out the completion of those 125 clinics to Iraqi firms for about $40 million.

The Parsons point to me in the course of performing this audit was that they had two significant complaints. One, this was supposed to be a 2-year program and they were unilaterally directed by the Corps of Engineers to make it a 1-year program, so they were expected to build 150 clinics in a year and the site selection was difficult in many cases. There was one that was placed where there was a swamp. There was so much remedial work that had to be done at a number of the sites that they simply made some of the PHCs unworkable.

Mr. LANTOS. Since time is short, may I just followup on one item, Mr. Chairman?

Mr. BOWEN. Yes, sir.

Mr. LANTOS. When I was in Iraq, I met one of the most impressive human beings I ever met, General Petraeus, who took me around on his helicopter and we landed many places. He showed us that with $5,000, with $20,000, projects were completed. We looked at them. They were functioning, and so on.

In your report, Ambassador Satterfield, and I wonder if you can tell us when you went out to take over this assignment?

Mr. SATTERFIELD. In May of last year.

Mr. LANTOS. In May of?

Mr. SATTERFIELD. Of 2005.

Mr. LANTOS. Of 2005. Your report says, and I can quote it, but I will paraphrase it and you correct me. You say you took many of these projects away from these multinational firms, gave them to local firms, and saved something like 40 percent. You are not in the field of construction management, but you have some brains, and you took it away at this incredible profit margin, gave it to Iraqi firms at a 40 percent cost saving, and your inference was that they are now being completed.

Mr. SATTERFIELD. Yes, Congressman.

Mr. LANTOS. How do you explain this?

Mr. SATTERFIELD. Congressman, I will build with the remarks to my two colleagues here, to answer in as plain English as I can the query that you made. What is responsible for the mistakes that have been made and what is the course to success with the remaining funds, the remaining projects in Iraq that taxpayer dollars provide for. It is an examination at the highest levels, not just at a working level, of feasibility. Does the project make sense? Does it make sense not when it was conceived, which may be several years previous, but does it make sense in the political, security and needs environment of Iraq today?

That cannot be a one-time assessment. It has to be a rolling assessment with dramatic re-thinking at all points as necessitated. What is oversight? Oversight has to be continuous. It has to be on the ground. It has to also reflect the unique circumstances in Iraq. You need more, not less, oversight in the difficult circumstances that prevail in that country, both the issue of corruption, inadequate performance standards, and also the security environment.

And finally, you need the ability to move from one project or mode of funding or contracting to another, as flexibly as possible, as you assess feasibility, as you review the results of your tight oversight procedures. And you need to do it if you are operating in Iraq in a way that is as integrated as possible between all of the civilian and military agencies operating in that country as possible. There can't be stovepipes.

Chairman TOM DAVIS. The gentleman's time has expired. Mr. Lantos, you have had 10 minutes.

Mr. Gutknecht.

Mr. GUTKNECHT. Thank you, Mr. Chairman.

First of all, I just want to say to Ambassador Satterfield, on behalf of myself and Mr. Shays and others who were in Iraq in July, I just want to congratulate you. I have seldom dealt with someone who was more professional and told us the good, the bad and the ugly of things that were actually happening on the ground. The briefing that you gave us was among the best I have ever received. I just want to say that we are fortunate to have public servants like yourself, who serve at great sacrifice in dangerous places like Baghdad. I appreciated not only the information you gave us, but the professionalism. It has had quite an impact on me.

I want to come back to a couple of things that are sort of glossed over. Ms. Schinasi, this report, and I want to thank you for it, I think it is helpful, but even the title, it seems to me, is awfully soft: Continued Progress Requires Overcoming Contract Management Challenges. "Challenge" is a pretty soft word, isn't it?

Ms. SCHINASI. It is one that we believe tries to reflect the positive side, that something can be done, that we still have time to make changes to get better outcomes.

Mr. GUTKNECHT. OK, well I will accept that, but let me come back to something else that you said in a rather soft way. For example, believe it or not, many years ago I was a business major, and I wasn't all that great a student, but I do remember Management 101. You start with objectives. You have a budget. And then you figure out some way to measure or set up a matrix in terms

of how are you doing relative to your objectives, with the budget and so forth.

It strikes me that we don't really have that now. In fact, with all due respect to what we hear from the Pentagon often, the answer to every question we give them is, we'll send more money. OK? I am not one who believes that more money is the answer. In fact, I will just tell you parenthetically that I remember when Paul Wolfowitz came up and gave us a briefing before this all started. I will never forget what he told us. He said that if you divided up the wealth of Iraq per capita, it was about the third wealthiest country in the world. And that once Saddam was toppled, and we had regime change, which sounded so simple and so soft, it was like changing a suit, and this would be easy and it wouldn't be expensive for the taxpayers.

The last time I checked, we have invested $323 billion in that country. There doesn't seem to be any real end in sight.

And so what I want to know, again going back to the word "challenges," do you foresee that we are really beginning to set up using Management 101, real objectives with real budgets and real ways of measuring those things?

Ms. SCHINASI. Clearly, we have progressed from where we were when we started. So we are on a continuum here. I think there are different ways to look at the need to measure, but I agree absolutely with you, if we don't know where we are trying to go, and don't have the measures, then we won't know how far it takes, how much longer it is going to take us to get there.

At the project level, I think something that Ambassador Satterfield said is encouraging, and that is we are developing measures now to understand what it will cost to complete these projects, but the fact that has been lacking until now is a very, very serious deficiency.

Mr. GUTKNECHT. Let me just come back to the last point, and it is sort of embedded in all of our questions and all of the concerns that we represent among our constituents, and that is the word "consequences." Because it strikes me that even today, when we talk about some of these colossal failures, and enormous cost overruns, it just seems that there isn't really a consequence to these contractors.

I would welcome input from any of the members of the panel. What can we do as a Congress to make sure that we have real accountability and that people are held accountable for the amount of money that is being wasted?

Ms. SCHINASI. I think one of the most significant findings in the report that we issued Monday, that the chairman referenced on whether or not the Government is recovering costs from contractors, is that we have a situation where we have not been able to definitize our contracts. In English, that means agree on the terms and conditions under which the contractors will be operating, what are the Government's requirements.

What we found in that report that we issued Monday is that if we do not definitize those contracts before we start work, the contracting officers believe they have no flexibility to recover costs that in retrospect are determined to be unreasonable or unallowable or unallocable. So that is an internal control that we expect to be

working in this cost-plus environment that we have talked about this morning, but it is apparently not working.

Mr. GUTKNECHT. Mr. Chairman, my time is about expired. I just want to say that we owe it, this committee owes it to a much more aggressive oversight of all of this. I think it has to be built on real objectives, manageable objectives, but more importantly and finally, people have to be held accountable. I think that is one area where both your office and this Congress have really not done the job that needs to be done. I think it is one thing that the American people expect and I don't think those expectations are unreasonable.

I yield back my time.

Chairman TOM DAVIS. Thank you. Mr. Gutknecht, that is always a problem is when things go wrong, nobody ever loses their job, whether they are losing data or whatever.

Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman.

I would agree with my colleague that we do need much more aggressive oversight. On that note, I would like to ask the chairman that we maybe have a hearing and bring before the committee some of the individuals who were discussed in the story about political cronyism at the Defense Department. I think when you have the former Deputy Director of the CPA's Washington Office saying publicly that we didn't tap the right people to do the job. Instead, we got people who went out there because of their political leanings, that we need to have aggressive oversight on that issue. I would suggest that we should have Jim O'Beirne, who apparently held this political job at the Defense Department, and others to come up here and under oath explain what they did and did not do.

Chairman TOM DAVIS. Mr. Bowen did report on that.

Mr. BOWEN. Yes, sir, Mr. Chairman, I did.

Chairman TOM DAVIS. You are welcome to ask him.

Mr. VAN HOLLEN. No, I heard you. You mean, in response to Mr. Waxman's statement or something else?

Chairman TOM DAVIS. In response to your question right now about the hiring practices over there.

Mr. BOWEN. In February, we issued our first report on human capital management and did identify in that report the fact that there were allegations of political elements in decisionmaking on hiring.

Mr. VAN HOLLEN. Thank you. I understand and I appreciate that. It seems to me we should get the people who were directly involved, Mr. Chairman. That is what I am saying.

Let me go on. I have some questions with respect to particular contracting, because I do think that in order to protect the taxpayers' money and try to get at the bottom of some of these contracting problems, we do need exactly the oversight that we have all talked about.

There is a contract that this committee, in fact the subcommittee that Mr. Shays chairs, has been pursuing with respect to one of the Army's LOGCAP contracts. So Ms. Ballard, I have a couple of questions for you, because back on June 13th of this year in that subcommittee, I asked about a news report about a contractor called

Blackwater USA, which was one of the fourth-tier contractors under Halliburton's umbrella contract of $16 billion. They were a logistic support contract. We have a copy on the screen. It is not that visible, but essentially what it does is, and I hope you have a copy in front of you.

It shows that the individual employees that were hired by Blackwater were being paid $600 a day. Blackwater was then charging $815 a day. Then you go right up through the different subs and get up to Halliburton. As Mr. McHugh was pointing out earlier, one of the things about a cost-plus contract is there is absolutely no disincentive to the person at the top of the food chain or anywhere else to charge a reasonable price because they get rewarded on a percentage basis on the overall amount.

In any event, this is a list. We had a hearing to try and figure out exactly what this contract was costing the taxpayers. And so we wrote to the Secretary of the Army and we asked a question with respect to these contracts. The response we got back was in a letter dated July 14, 2006. I just want to read the third paragraph, because it has created a real mystery for the subcommittee. That paragraph says, under the provisions of the LOGCAP contract, the U.S. military provides all armed force protection for KBR unless otherwise directed.

Additionally, the LOGCAP contract states that KBR personnel cannot carry weapons without the explicit approval of the theater commander. And then there is this sentence, "To date, KBR has not pursued any requests under the LOGCAP contract for personnel to carry weapons, nor has the theater commander directed or authorized KBR or any LOGCAP subcontractor to carry weapons." KBR has stated they have no knowledge of any subcontractor utilizing private armed security under the LOGCAP contract. Do you see that here?

Well, if this letter is correct, from the Army, it suggests that this whole subcontract for private security personnel was never authorized. Is that right?

Ms. BALLARD. Congressman, the information stated in Secretary Harvey's letter is accurate. I can't comment at this time on this document that you have given me, but I would be happy to take it back for the record. I checked before I came over to testify, and in fact exactly what is quoted in Harvey's letter is the information that I validated before this morning.

Mr. VAN HOLLEN. Alright.

Chairman TOM DAVIS. And that question will be in the record.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. If I could also put those documents in the record?

[The information referred to follows:]

Multiple Layers of Security Subcontracts Under Halliburton's Troop Support Contract

	Company	Costs	% Increase
•	Individual Employee	$600/day	--
•	Blackwater (USA)	$815/day	36%
•	Regency Hotel (Kuwait)	$1200-$1500/day	100-150%
•	ESS (Germany)	Unknown	Unknown
•	Halliburton (USA)	Costs + Up to 3% Fee	Unknown
	Total Cost to Taxpayer	Unknown	Unknown

Source: News & Observer (Oct. 24, 2004).

SECRETARY OF THE ARMY
WASHINGTON

JUL 14 2006

The Honorable Christopher Shays
Chairman
Subcommittee on National Security, Emerging
Threats and International Relations
Committee on Government Reform
United States House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Thank you for your letter to the Secretary of Defense requesting information from then Brigadier, now Major General Jerome Johnson, Commander U.S. Army Field Support Command, regarding the cost of third-tier subcontractors for security contracts under the Army's Logistics Civil Augmentation Program (LOGCAP). Secretary Rumsfeld has asked me to respond on his behalf.

Based on information provided to the Army by Kellogg, Brown and Root (KBR), KBR has never directly hired a private security contractor in support of the execution of a statement of work under any LOGCAP III Task Order. Additionally, KBR has queried ESS and they are unaware of any services under the LOGCAP contract that were provided by Blackwater USA. KBR is continuing to look into whether any private security firm may have been hired by ESS or any other subcontractor (including Regency Hotel) in support of LOGCAP III.

Under the provisions of the LOGCAP contract, the U.S. military provides all armed force protection for KBR unless otherwise directed. Additionally, the LOGCAP contract states that KBR personnel cannot carry weapons without the explicit approval of the theater commander. To date, KBR has not pursued any requests under the LOGCAP contract for personnel to carry weapons nor has the theater commander directed or authorized KBR or any LOGCAP subcontractor to carry weapons. KBR has stated they have no knowledge of any subcontractor utilizing private armed security under the LOGCAP contract.

In regards to your request for reports analyzing the cost of paying contractors for security services or logistical support, we are unaware of any Department of Defense reports in these areas. The Congressional Budget Office (CBO) has produced a report titled "Logistics Support for Deployed Military Forces," dated October 2005 which compares the cost of paying contractors to provide security services or logistical support under the LOGCAP contract with the cost to the Army of providing the services or support itself. A copy of that report is enclosed.

With respect to withholding payments, the Office of the Secretary of Defense approved a deviation to Federal Acquisition Regulation clause 52.216.26, "Payments of Allowable Costs Before Definitization," on February 2, 2005, for task orders issued under the LOGCAP contract (DAAA09-02-D-0007). The deviation authorizes the Department of the Army to reimburse and make payment to the LOGCAP prime contractor on undefinitized task orders at rates up to 100 percent of allowable costs until June 30, 2005 or until the contract actions are definitized, whichever occurs first. The deviation has been extended to June 30, 2007. Given the volatility in requirements under contingency contracting, it is foreseeable there may be additional undefinitized task orders under LOGCAP. However, since March 2005, the use of Undefinitized Contract Actions has been minimized to the maximum extent possible and all such actions issued under the LOGCAP contract have been definitized within the 180 day regulatory requirement.

A process has been developed in conjunction with the Defense Contracts Audit Agency, Army pricing specialists, and the contracting officer to evaluate unsupported costs. KBR is required to provide supporting documentation to the satisfaction of the contracting officer prior to the cost being accepted. I have asked the Office of the Chief of Legislative Liaison (OCLL) to work directly with your staff to address any specific issues surrounding unsupported costs, or other issues needing additional clarification.

Finally, regarding the request for copies of KBR's subcontract with ESS and Regency Hotel, as well as any consent package for the KBR-ESS subcontract, this information has been requested from KBR, and will be forwarded to Committee staff upon receipt.

I trust this information will resolve the matter to your satisfaction. I am providing a courtesy copy of this letter to Representative Waxman.

Sincerely,

Francis J. Harvey

Enclosure

AGREEMENT FOR SECURITY SERVICES

This Agreement (hereinafter referred to as "Agreement") is made and entered into on this _12___ day of March, 2004 by and between Regency Hotel & Hospital Company, P.O. Box 700, Safat 13700 Kuwait (hereinafter referred to as "REGENCY"), and Blackwater Security Consulting, Inc., located at 850 Puddin Ridge Road, Moyock, North Carolina 27959 (hereinafter referred to as "BLACKWATER").

WHEREAS, **REGENCY** has signed an Agreement with ESS Support Services Worldwide, Eurest Support Services (Cyprus) International Limited 84 Nicou Pattichi Street, Maritania Building, 3070 Limassol, Cyprus, Postal Address: P.O. Box 52408, 4064 Limassol, Cyprus a contractor providing catering support services and design and build services to US Armed Forces and other US contracting agencies in Iraq and Kuwait hereinafter referred to as "ESS" and whereas **REGENCY** is desirous to obtain security services to support **REGENCY**'s contract with **ESS** in Iraq, Kuwait, Jordan and Turkey (hereinafter collectively referred to as the "Territory"); and

WHEREAS, **BLACKWATER** has familiarized itself with the ESS and REGENCY operations and being professionally experienced in the security field of works to provide such services; and

WHEAREAS, **REGENCY** and **BLACKWATER** desire to enter into an agreement wherein **BLACKWATER** provides certain security services in support of the ESS Contracts and ESS operations in the Territory utilizing the specialized management, personnel and resources currently utilized by **BLACKWATER** in its business.

NOW, THEREFORE, in consideration of the mutual promises, agreements and covenants and for other good and valuable consideration, the receipt and sufficiency of which are acknowledged by the parties hereto, the parties hereto agree as follows:

ARTICLE 1
BLACKWATER RESPONSIBILITY & WORK SCOPE

1.1 **BLACKWATER** shall carry out Security Services, as defined below in this Section, for ESS in the Territory, including movement of ESS's staff, management and workforce throughout Kuwait and Iraq, and across country borders, including the borders of Iraq, Kuwait, Turkey and Jordon. **BLACKWATER** shall provide to ESS the following security services listed in Appendix A. (Appendix A, Provision of Security Services, is hereinafter referred to as the "Security Services"), at the quantities and unit prices contained in Appendix B.

1.2 **BLACKWATER** Conducting of Security Operations.

1.2.1 **BLACKWATER** is an independent contractor of **REGENCY** any and all employees of **BLACKWATER** shall in no way be deemed

employees of **REGENCY** for any purpose hereunder. **REGENCY** shall designate all Security Services to be performed hereunder in regard to the ultimate result to be obtained; however, **BLACKWATER** shall have complete and absolute control of the methods and details of the performance of such designated Security Services. All services provided hereunder shall be performed to the satisfaction of **REGENCY** and ESS. The Parties shall mutually define a service level agreement within thirty (30) days of mobilization which will enable performance to be measured by both parties.

1.2.2 **BLACKWATER** shall perform the work in a safe, proper and workmanlike manner in accordance with generally accepted current good practices of the security industry. The protective services detail will undergo a pre-deployment training mission to include Mission Standard Operational Procedures, adherence to standardized use of deadly force policies and rules of engagement. **BLACKWATER** will implement a Mission-Standard Operational Procedures manual that adheres to Diplomatic Security Protective Operations. **BLACKWATER** views the Security Services it will provide to ESS and **REGENCY** as a Law enforcement mission and will adhere to the Diplomatic Security Services type Deadly Force Policy and Rules of Engagement. **REGENCY** and ESS understand that such policies are subject to approval by the US Embassy, Chief of Mission, and are established by in Territory personnel.

1.2.3 **BLACKWATER** shall provide Security Services within the Territory in accordance with the instructions given by ESS; provided, however, that **BLACKWATER** shall, at all times, have complete authority and responsibility to make decisions regarding the suitability for movement required by ESS and the type and level of protection required for ESS personnel. Any such decisions made by **BLACKWATER** shall be based on weather, current threat activity in the Territory and all other factors which may affect the safe movement of ESS personnel.

1.2.4 **BLACKWATER** shall at all times be the sole judge of the safety and proprietary of ESS staff, management and workforce personnel movement and Security services, as well as the level and type of Security Services provided. **BLACKWATER** shall be under an absolute duty at all times to exercise its own reasonable discretion with respect to safe operations, movement of ESS personnel and the type and level of Security Services provided to ESS; and no direction given by ESS shall be deemed to lessen this duty or in any way to relieve **BLACKWATER** of this responsibility.

1.2.5 **REGENCY** and ESS understand and acknowledge that certain of the services set forth in this Article 1 may require licenses and prior

approval from various government agencies of the U.S. or other applicable jurisdictions. **BLACKWATER** shall endeavour to obtain, with **REGENCY**'s and ESS's good faith cooperation, all such necessary approvals and licenses; provided, however, **BLACKWATER** shall not be responsible for any delay or non-performance caused by any act or omission of any government body.

ARTICLE 2
REGENCY RESPONSIBILITY

In order that **BLACKWATER** shall provide its Security Services in an expeditious, safe and professional manner, **REGENCY** shall:

2.1 Include **BLACKWATER** in ESS's anticipated movement planning of staff, management, and workforce so that **BLACKWATER** can plan protection security for these movements well in advance if possible. **REGENCY** will request that ESS provide a schedule of activities and movements in need of security services at least twenty four (24) hours in advance and for all missions of the **BLACKWATER** Protection Service Details. Emergency requirements (those with less than 24 hours notice) will be considered but cannot always be guaranteed because of the threat level in the Iraq environment or the inability to change prior commitments.

2.2 **REGENCY** or ESS will provide all **BLACKWATER** personnel operating in the Territory with housing and subsistence. If **REGENCY**, or ESS, is unable to provide such housing and subsistence to any individual **BLACKWATER** personnel providing Security Services to ESS in the Territory, **REGENCY** will provide a per diem allowance to each such **BLACKWATER** person. The amount of the per diem allowance shall be mutually agreed to by both parties, but in no event shall such per diem be less than the most recent published U.S. government JTR rates. The housing standard shall be single occupancy for supervisory level employees and double occupancy for all others. Subsistence shall mean three (3) meals per day and access to laundry facilities and international phone call services when appropriate and Internet access to the extent that such services are physically available; provided, however, that each individual security person (whether U.S. citizen or third country national) utilizing such services shall be individually responsible for all costs associated with such services to the extent, in other words, **BLACKWATER**, shall not be responsible for any costs associated with Subsistence services.

2.3 **REGENCY** or ESS will provide **BLACKWATER**, at no cost to **BLACKWATER** with office space and equipment on ESS sites in Kuwait and Baghdad in order to support the necessary command and control elements of the **BLACKWATER** operation in support of ESS operations in the Territory. In the event that ESS is unable to provide office space and equipment at ESS sites,

REGENCY will provide optional space near ESS sites at **REGENCY's** discretion.

2.4 **REGENCY**, at no cost to **BLACKWATER**, will provide Kuwait visas, work permits and administration support for **BLACKWATER** personnel assigned to support ESS operations and working under the terms and conditions of this Agreement. This administrative support will be provided at **REGENCY's** expense.

ARTICLE 3
REGENCY PURCHASE OR LEASE OF OPERATIONS SUPPORT EQUIPMENT AND VEHICLES

REGENCY will purchase or lease the following equipment necessary for the Security Services (hereinafter referred to as the "Equipment") as part of the price charged per man per day as defined in Appendix B. These costs will be in the form of a fixed dollar amount, per man per day, as outlined in Appendix B, with some Equipment leased by and some items owned by **REGENCY**, but in every case Equipment purchase, maintenance and replacement is **REGENCY's** responsibility except as agreed to by the parties as delineated in Appendix B. **REGENCY** bears the risk of Equipment replacement and acquisition of new Equipment or replacement Equipment as required to perform the tasks outlined in this Agreement. **REGENCY** shall maintain ownership of all Equipment purchased by **REGENCY** during the Term of this Agreement, unless otherwise mutually agreed to by the parties. **REGENCY** will require and follow **BLACKWATER** guidance on the purchase of support items. It is **BLACKWATER's** responsibility to provide the final decision on types of support items to purchase or lease.

ARTICLE 4
CONTRACT AGREEMENT TERM

This Agreement is valid for a period of one (1) year from the date of the last Party's signature to this Agreement (the "Effective Date") and will automatically be renewed for an additional one-year period under the same terms and conditions unless cancelled with thirty (30) days written advance notice by either party. **REGENCY** shall have the right to terminate this Agreement or any portion hereof, upon thirty (30) days prior written notice in the event that ESS is given written notice by Kellogg, Brown & Root of cancellation of ESS's contracts, for any reason, or in the event that ESS receives written notice from Kellogg, Brown & Root that ESS is no longer allowed to use any form of private security services. Notice of cancellation will be sent by **REGENCY** to **BLACKWATER** at the address listed in this document. In the event of Cancellation **BLACKWATER** shall be paid its compensation for services performed to the date of cancellation plus notification period.

ARTICLE 5
SCHEDULE OF WORKS

BLACKWATER's Mobilization period is twenty-one (21) calendar days from the Effective Date of the mobilization payment. **BLACKWATER** shall receive the mutually agreed mobilization payment as outlined in Article 8 from **REGENCY** within ten (10) days of signing of this Agreement, provided **REGENCY** has received the mobilization payment from ESS within the timeframe identified in the Agreement between ESS and **REGENCY**; provided further that **BLACKWATER** is relieved from any responsibility under this agreement until it receives such mobilization payment.

BLACKWATER will provide to ESS Security protection security details on an as required basis throughout the term of the Agreement.

ARTICLE 6
INSURANCES & INDEMNIFICATION

6.1 Insurance.

6.1.1 **BLACKWATER** will obtain and maintain in force at all times during the term of the Agreement insurance of the type and in the minimum amounts set forth on Appendix D attached to this Agreement and incorporated herein by reference. **BLACKWATER** will name **REGENCY** as an additional insured and will provide **REGENCY** with certificates of insurance as evidence of such coverage upon execution of this Agreement.

6.1.2 **BLACKWATER** is required to maintain Defense Base Act ("DBA") insurance on all of its employees working in the provision of Security Services. **BLACKWATER** will make all reasonable efforts to obtain the lowest possible cost for this insurance either by obtaining the insurance through REGENCY sources or combining **REGENCY** efforts with ESS efforts to obtain the best possible cost for this insurance. The cost of this insurance shall be passed on at cost from **REGENCY/BLACKWATER** to ESS for payment of same. DBA insurance payment is part of the Advance Payment, as defined in Article 8.1 below, and paid in conjunction with the Advance Payment. If ESS can provide DBA insurance coverage through ESS insurance facilities, then ESS will provide to **REGENCY/BLACKWATER** pass through coverage via appropriate insurance industry documentation.

6.2 Indemnification. **BLACKWATER** agrees to indemnify, defend and save **REGENCY** harmless from and against any and all claims, expenses, loss or liability whatsoever, including court costs and attorneys' fees, arising out of or in connection with the act or omissions of **BLACKWATER**, its employees and agents including breach of this Agreement; provided, however, **BLACKWATER** shall not be obligated to indemnify,

defend and hold **REGENCY** harmless for any claims, expenses, loss or liability arising solely out of or in connection with the negligent acts or omissions of **REGENCY** or **ESS** and their agents or employees. This provision shall survive the termination of this Agreement. **REGENCY** agrees to indemnify, defend and save **BLACKWATER** harmless from and against any and all claims, expenses, loss or liability whatsoever, including court costs and attorneys' fees, arising out of or in connection with the act or omissions of **REGENCY**, its employees, representatives, subcontractors, officers and agents including breach of this agreement; provided however, **REGENCY** shall not be obligated to indemnify, defend and hold **BLACKWATER** harmless for any claims, expenses, loss or liability arising solely out of or in connection with the negligent acts or omissions of **BLACKWATER** and its agents or employees. **REGENCY** understands and agrees that **BLACKWATER** is providing protective services in a volatile, hostile and extremely dangerous environment. Despite **BLACKWATER** performing protective services, there is simply no way to avert the high risk of injury or death to ESS and **REGENCY** personnel operating in this environment. This provision shall survive the termination of this Agreement.

ARTICLE 7
TAXES

BLACKWATER shall be responsible for its own taxes, duties, stamps, and fees imposed by the United States Government in the United States. **REGENCY** shall be responsible for its own taxes, duties, stamps, and fees imposed by the Kuwaiti Government, Iraqi Government, Jordanian Government or the US CPA.

REGENCY shall be responsible for any taxes, duties, stamps, and fees imposed by the Kuwaiti Government, Iraqi Government, Jordanian Government, Turkish Government or the US CPA on **BLACKWATER**. **BLACKWATER** shall notify **REGENCY** within thirty (30) days of **BLACKWATER** becoming aware of or is notified that the Kuwaiti Government, Iraqi Government, Jordanian Government, Turkish Government or the US CPA is going to impose taxes, duties, stamps, and/or fees on **BLACKWATER**. **REGENCY** shall pay the taxes, duties, stamps and/or fees imposed on **BLACKWATER** by the Kuwaiti Government, Iraqi Government, Jordanian Government or the US CPA directly to Governmental entity imposing the taxes, duties, stamps and/or fees or shall reimburse **BLACKWATER** through the monthly invoicing procedures in Article 8.

ARTICLE 8
PAYMENTS, TERMS OF PAYMENT & RECORDS MAINTENANCE

8.1 Advance Payment. As per Article 5, **REGENCY** shall pay to **BLACKWATER** within ten (10) days of the Effective Date of this Agreement an advance payment ("Advance Payment") consisting of:

8.1.1 Mobilization payment: **$320,000** (three hundred and twenty thousand United States Dollars). See Appendix B for details.

8.1.2 DBA insurance payment: **$ 407,751** (four hundred and seven thousand seven hundred and fifty one United States Dollars). See Article 6 for details.

As such, the total Advance Payment, payable within ten (10) days of the Effective Date of this Agreement, shall be $727,751 (seven hundred twenty seven thousand seven hundred fifty one United States Dollars), which includes the DBA insurance payment. In consideration for this Advance Payment, **BLACKWATER**, will credit **REGENCY** one-twelfth (1/12) of the total Mobilization Payment against each monthly billing for twelve (12) consecutive monthly billing periods following the Effective Date of this Agreement, thus reducing the total amount billed to **REGENCY** in twelve (12) equal amounts. See Appendix C for monthly billing sample.

8.2 Terms and Method of Payment, Invoicing & Substantiating Documents. Billing periods shall be based on calendar months for the duration of this Agreement, see Appendix C. **BLACKWATER** shall provide a complete invoice to **REGENCY** within three (3) days (or as soon thereafter as is reasonable practicable) after the end of the monthly billing period. The invoice shall be accompanied by appropriate supporting documentation to validate expensed items as outlined in Appendix B. **REGENCY** shall make payment to **BLACKWATER** within thirty (30) days of receipt of **BLACKWATER's** monthly invoices.

In the event, that there are disputed invoice items, the payment terms remain in force for the items not in dispute.

REGENCY shall pay **BLACKWATER** by wire transfer of funds in United States Dollars to **BLACKWATER's** designated bank account. **BLACKWATER** will provide **REGENCY** under separate cover its banking information.

8.3 Maintenance of Records. **BLACKWATER** shall maintain a true and correct set of records pertaining to work performed and services provided hereunder and all transactions related thereto throughout the Term of this Agreement. **BLACKWATER** further agrees to retain all such records for a period of not less than two years after termination of this Agreement. **REGENCY** may upon reasonable notice and other terms time audit any and all records of **BLACKWATER** relative to the work performed hereunder and all transactions related thereto for the sole purpose of determining compliance with the terms and conditions of this Agreement, as well as the invoices submitted and prices paid throughout the Term of this Agreement.

ARTICLE 9
WORK SITE ACCESS

Work site access to ESS locations and areas remain ESS responsibility. **REGENCY** will request ESS provide unhindered access to ESS sites for **BLACKWATER**, subject to ESS client approval, throughout the term of this Agreement to fulfill the Security

Services. **REGENCY** understands that without such access, **BLACKWATER** may be unable to effectively provide the Security Services.

ARTICLE 10
INSTRUCTION & DECISIONS

10.1 **REGENCY** will delegate its designated representative ("Designated Representative") in writing to the **BLACKWATER** within five (5) days of the Effective Date of this Agreement. All decisions and/or instructions issued by the **REGENCY** Designated Representative to **BLACKWATER** will be binding on **BLACKWATER** under the terms and conditions of this Agreement. The **BLACKWATER** Iraq Security Manager and Kuwait Security Manager will coordinate all actions regarding security operations through the ESS Owner Representative as well as the **REGENCY** Owner Representative. **BLACKWATER** will delegate its Iraq Security Manager and Kuwait Security Manager in writing to **REGENCY** within five (5) days of the Effective Date of this Agreement.

10.2 Communications Policy and Instructions. Each party agrees that it will not, without the prior written consent of the other, issue any press release or announcement or otherwise disclose the existence or nature of this Agreement and/or proposed or contemplated business arrangement(s), transaction(s), negotiation(s), or other related jointly discussed business pursuits. The two parties mutually agree to develop a standard operating procedure (SOP) in regard to the handling of press inquiries.

10.3 Accident and Incident Reporting Procedures. Due to the nature of the services being provided and the area of operations where the services will be provided, from time to time the parties may have to report on accidents or incidents involving **REGENCY** provided equipment or incidents involving **BLACKWATER** personnel and/or **REGENCY** provided equipment. Therefore, within thirty (30) days of execution of this Agreement the parties mutually agree to develop standard operating procedures to address accident and incident reporting.

ARTICLE 11
GOVERNING LAW & SETTLEMENT OF DISPUTES

11.1 Any disputes of any nature which arise between the parties, with regard to the interpretation of this Agreement or relative to the performance of any of the contractual obligations, whether such disputes arise before, during or after the execution of the Agreement, shall, if possible, be amicably settled. Notice of a dispute shall be served by one party upon the other by written notice.

11.2 Any dispute which cannot, in the opinion of either party, be amicably settled arising in connection with the present Agreement shall be finally settled by binding

arbitration. Within thirty (30) days of a party's notice to arbitrate, each party will appoint one arbitrator, with a third arbitrator to be appointed and mutually agreed between the two parties' appointed arbitrators. If the parties are unable to agree on the appointment of arbitrators within one (1) month of the non-complaining party's receipt of the complaining party's dispute, the appointment shall be subject to the ruling of the International Chamber of Commerce, in Paris, France.

11.3 Arbitration shall be conducted in accordance with the Rules of Arbitration of the International Chamber of Commerce and shall be held in Washington, D.C., and conducted in the English language.

11.4 The validity and construction of this Agreement shall be governed by the Laws of the State of North Carolina.

11.5 This Agreement shall not be construed to present any contractual or legal relationship with any third party.

ARTICLE 12
TERMINATION, EXTENSION & EXPANSION

12.1 Termination.

12.1.1 In the event of non-performance of any term or condition of this Agreement by **BLACKWATER, BLACKWATER** will be given written notice of the non-performance. **BLACKWATER** will be given thirty (30) days from the date that the non-performance notice was received to rectify the noted non-performance; provided, that provided, that if the noted "non-performance" is not capable of being cured within such thirty (30) days and BLACKWATER is in good faith attempting to cure and rectify such non-performance, then BLACKWATER shall be given a reasonable time to cure such non-performance (such time not to exceed ninety (90) days). In the event the non-performance issue is not corrected within this thirty (30) (or other applicable time period) day period, **REGENCY** may exercise its right to terminate this Agreement. **BLACKWATER** may cancel this agreement upon thirty (30) days written notice for "non performance" or material breach by **REGENCY**, including failure to make payment to **BLACKWATER** on the terms and conditions set forth in this Agreement. **REGENCY** will be given written notice of the non-performance. **REGENCY** will be given thirty (30) days to rectify the noted "non performance"; provided, that if the noted "non-performance" is not capable of being cured within such thirty (30) days and **REGENCY** is in good faith attempting to cure and rectify such non-performance, then **REGENCY** shall be given a reasonable time to cure such non-performance (such time not to exceed ninety (90) days); provided, however, that the initial thirty (30) day time period shall not be extended upon **REGENCY's** failure to make payment to **BLACKWATER** on the terms and conditions set forth in this Agreement shall. In the event the non-performance issue is not corrected within a thirty (30) day period (or other applicable time period) **BLACKWATER** may exercise its right to cancel this Agreement.

12.1.2 In the event of termination under paragraph 12.1.1, above by **REGENCY**, **BLACKWATER** shall be paid its compensation for services performed to the date of termination plus notification period for all of those services not in dispute.

12.2 Extension of Time. **REGENCY** may extend the term of this Agreement by written notice to **BLACKWATER**. A preliminary notice of its intent to extend will be sent at least thirty (30) days before the Agreement expires. The preliminary notice does not commit to an extension. Any extension would be in accordance with the terms and conditions in this Agreement unless otherwise mutually agreed to by the parties. The unit pricing during the extension period will be the same as reflected in Appendix B as adjusted by the change in the United States Consumer Price Index for this period and or other unforeseeable and uncontrollable events that may, upon mutual agreement of the parties, require an economic price adjustment.

12.3 Expansion of Security Services. **REGENCY**, at its discretion, may add security team members by individual category as defined in Appendix A and B.

12.4 Terms of Mobilization and Demobilization of Personnel.

12.4.1 The initial mobilization of a minimum of thirty four (34) Security Personnel, as defined in Appendix A, will remain constant for ninety (90) days following the Effective Date of this Agreement before any changes are made.

12.4.2 The initial increase of the number of Security Personnel, as defined in Appendix A, including T1s, T2s and/or T3s, may occur thirty (30) days following the payment of the Mobilization Payment set forth in Section 8.1.1. Demobilization of additional Security Personnel, as defined in Appendix A, may occur sixty (60) days following the Effective Date of mobilization of the individual.

12.4.3 Demobilization of the original thirty four (34) Security Personnel, as defined in Appendix A, may occur after the initial (90) ninety-day period and this demobilization will require thirty (30) days.

ARTICLE 13
FORCE MAJEURE

Both parties acknowledge that the Security Services are taking place in an area defined as a "War Zone" as defined by the parties, therefore the Force Majeure is defined in principle as acts of God, or actions taken by ruling authorities or military forces in charge of the Territories where operations are taking place.

Upon the occurrence of Force Majeure event, BLACKWATER shall notify REGENCY within 24 hours of such event stating the cause and probable consequences.

Where the case of Force Majeure remains unresolved for a period exceeding fourteen (14) days, the parties shall agree on alternative arrangements to continue performance of the Security Services under this Agreement. If no agreement or resolution has been reached

within ninety (90) days from notification, REGENCY shall have the right to terminate the Agreement.

ARTICLE 14
CONFIDENTIALITY

Each party to this Agreement shall regard and treat all information concerning the other party's operations which are obtained by the other party in the course of rendering services hereunder as confidential and shall not divulge any such information to any third party and shall not permit any of its officers, agents, representatives, employees or subcontractors to do so. The obligations regarding the confidentiality of information as set out in this Article 14 shall survive the termination of this Agreement for five (5) years regardless of the causes or reason for such termination by either party hereto.

14.1 With respect to any information, during the term of this Agreement, ("Disclosure Period"), which at the time of disclosure by the disclosing party ("Owner") is "Proprietary Information" to, the party receiving such information ("Recipient") agrees the Recipient shall – (1) use any Proprietary Information it receives from the party transmitting Proprietary Information only for the purposes contemplated by this Agreement and shall not otherwise use such Proprietary Information for its own benefit and (2) shall maintain such Proprietary Information in confidence, and not disclose it to any other person, corporation, or other entity. Recipient shall restrict disclosure of the information only to its employees who have the need to know, and instruct its employees that such information is proprietary to the Owner. Examples of "Proprietary Information" include, but are not limited to, information as to any of the Party's customers, prices, sales techniques, estimating and pricing systems, internal cost controls, production processes and methods, product planning and development programs, marketing plans, product information, inventions, blueprints, sketches and drawings, technical and business concepts, training programs, manuals, materials and information related to or associated with the Party's business in any manner or respect.

14.2 In the event Owner verbally discloses its Proprietary Information to Recipient, Owner agrees to identify the information as Proprietary Information at the time of such verbal disclosure.

14.3 The parties agree that information shall not be deemed proprietary and the Recipient shall have no obligation with respect to any such information which is already known to Recipient free of any obligation of confidence; has been published or was otherwise publicly known when Owner disclosed it to Recipient; or is rightfully received by Recipient; or is rightfully received by Recipient from a third party; or becomes publicly available through no wrongful act by Recipient; or is hereafter furnished by Owner to others without a similar restriction on disclosure; or is independently developed by the Recipient (or its agents) without breach of this Agreement.

14.4 Owner represents and warrants that none of the information provided by Owner to Recipient under this Agreement will include or embody the proprietary information of any third party.

14.5 Owner's Proprietary Information disclosed to Recipient, and any copies thereof, shall be promptly destroyed, or returned to Owner, upon Owner's written request, and in the event of such requested destruction Recipient shall provide written certification of compliance within thirty (3) days of such request.

14.6 Should Recipient be faced with legal action or a requirement under Government regulations to disclose Owner's Proprietary Information, Recipient shall immediately notify Owner. Upon Owner's request, Recipient shall cooperate with Owner in contesting such a disclosure. Except in connection with failure to discharge responsibilities set forth in the preceding sentence, Recipient shall not be liable in damages for any disclosure of Owner's Proprietary Information pursuant to judicial action or Government regulations.

14.7 Nothing contained in this Agreement shall be construed as granting to either party any express or implied rights by license or otherwise to or in any of the other party's patents or unpatented inventions.

REGENCY agrees that during the term of the Agreement and for a period of one year following termination of this Agreement, **REGENCY** will not solicit or attempt to solicit any person or entity who is a director, officer, independent contractor, contractor, employee or agent of **BLACKWATER** or any of its subsidiaries to perform services for any entity other than **BLACKWATER** or in any way interfere with the relationship between any customer, supplier, licensee, licensor, franchisee or business relation and **BLACKWATER** or any of its subsidiaries without the prior written consent of **BLACKWATER**. **BLACKWATER** agrees that during the term of the Agreement and for a period of one year following termination of this Agreement, **BLACKWATER** will not solicit or attempt to solicit any person or entity who is a director, officer, employee or agent of **REGENCY** or any of its subsidiaries to perform services for any entity other than **REGENCY** or in any way interfere with the relationship between any customer, supplier, licensee, licensor, franchisee or business relation and **REGENCY** or any of its Subsidiaries without the prior written consent of **REGENCY**.

ARTICLE 15
SEVERABILITY

In case of any one or more of the provisions contained in this Agreement should be held or determined to be invalid, illegal or unenforceable in any respect, the legality and enforceability of the remaining provision(s) or underlying rights and obligation referred to herein should not in any way be effected, modified or impaired hereby.

ARTICLE 16
NOTICES

Any notices and other communication provided for or permitted hereunder will be made by hand delivery, registered or certified mail (return receipt requested), facsimile transmission or overnight air courier guaranteeing next-day delivery as follows:

REGENCY: Regency Hotel and Hospital Company
P.O. Box 700, Safat 13700
Kuwait City, Kuwait
Telephone: +965-572-8100
Fax: +965-572-3884
Email: jas@al-sane.net
Attn: Mr. Jameel A. R. Al Sane, Chairman

BLACKWATER: Blackwater USA
850 Puddin Ridge Road
Moyock, North Carolina 27959 USA
Telephone: (252) 435-0011
Fax: (252) 435-6388
Email: garyj@blackwaterusa.com
Attn: Mr. Gary Jackson, President

Either party hereto may change the above-designated address for notice hereunder upon giving the other party thirty (30) days written notice of such change. All such notices and communications will be deemed to have been duly given: at the time delivered by hand, if personally delivered; five (5) business days after being deposited in the mail, postage prepaid (registered or certified and return receipt requested), if mailed; when receipt acknowledged by confirmation sheet, if telecopied; the next business day after timely delivery to the courier, if sent by overnight courier, guaranteeing next-day delivery.

ARTICLE 17
EXTENT OF THE AGREEMENT

This Agreement sets forth the full and complete understanding of the parties as to the Agreement described above. This Agreement represents the entire and integrated Agreement between the parties and supersedes all prior negotiations, representations or agreements either written or oral. This Agreement may only be amended by written instrument signed by both parties. Nothing in this Agreement is intended to benefit any third party.

ARTICLE 18
ASSIGNMENT

This Agreement may not be assigned by **BLACKWATER** without the prior written consent of **REGENCY**, which consent may be withheld due to the nature of the Security Services provided and the Territory in which they are provided.

APPENDIX A

PROVISION OF SECUIRTY SERVICES

Based on currently known ESS requirements and area of operations threat analysis, thirty four (34) vetted US Ex-pat professional Security Personnel, as defined in Section 3.0 of this Appendix A below, will form the core of the security organization that will support ESS operations in the Territory. Individual security teams will be task organized to provide optimal protection based on current threat analysis and data, on the ground experience and deterrence capability. This total number of Security Personnel will allow modification of individual team composition based on the region requiring support, thus providing ESS with a fluid, flexible solution across the board with tactically sound and mission capable Personal Security Details.

Further to **BLACKWATER's** analysis of ESS requirements and the current threat in the Iraqi theater of operations as evidenced by the recent incidents against civilian entities in Fallujah, Ar Ramadi, Al Taji and Al Hillah, there are areas in Iraq that will require a minimum of three Security Personnel per vehicle. The current and foreseeable future threat will remain consistent and dangerous. Therefore, to provide tactically sound and fully mission capable Protective Security Details, the minimum team size is six operators with a minimum of two vehicles to support ESS movements.

To enhance security and reduce the potential threat to ESS management and staff movements, it is understood that the standard process for scheduling support requires twenty four (24) hours advance notification prior to any movement. Emergency movements will be handled on a case by case basis. It is also understood that emergency movements can impact previously scheduled support requirements.
BLACKWATER's Security Personnel for ESS will be composed of:

Type of Operator	Number
T1	2 (includes management team)
T2	12 (includes management team)
T3	20
Personnel Total	**34**

1.1.1 Innovative Processes

1.1.1.1 Management
BLACKWATER's management team is committed to proactively work with **REGENCY** and ESS management to:

- Manage costs and reduce them where and when possible and practical.
- Reduce the threat to ESS management staff and employees through efficient planning of movements along with task organized protection details to meet constantly changing threats.
- Develop, test and implement a plan or plans to employ vetted Iraqi security forces and or other security forces composed of other nationalities overtime, but only with **REGENCY** and ESS management prior approval. With the first review of these plans at sixty (60) days following mobilization.

- Provide **BLACKWATER** captured or acquired data on each ESS movement to **REGENCY** so that **REGENCY** can maintain a movement statistics database for **BLACKWATER**. This will provide **REGENCY** and **BLACKWATER** with the potential to enhance movement planning efficiency and thus cost effectiveness of security and ESS operations. This will also provide historical data to ESS for future operations planning and costing.

1.1.1.2 U.S. DoD, U.S. CPA and Contractor Access Control Cards for Iraq and Kuwait.

BLACKWATER will coordinate the appropriate level badges for authorized ESS management and staff personnel needed to gain access to U.S. Department of Defense (DoD) and U.S. Coalition Provisional Authority (CPA) facilities and areas. This will significantly enhance the efficiency of ESS personnel by reducing the time required and wasted in gaining access to applicable facilities in the Territory, and crossing borders within the Territory. The cost is included.

1.1.1.3 Aviation Services

Aviation support services offered to ESS will be priced separately as required and negotiated.

1.1.1.4 Communications

In addition to the typical mode of communications **REGENCY/BLACKWATER** will provide additional means of communication to ensure ESS management remains constantly up-to-date with operational issues. These additional means of communication consist of, but may not be limited to:

- Supporting a secure web site with real time data which will provide movement request submission and tracking of movement requests, information bulletins, current security environment analysis reports, news flashes or critical notices, contact information and any other information determined necessary by ESS. **REGENCY** will develop this secure website and implement the website.
- Providing a Bi-weekly intelligence assessment briefing / meeting overview with ESS management.
- Supporting Operational Management meetings with **REGENCY** and ESS management personnel on a bi-weekly basis.
- On **REGENCY** initiated or authored correspondence to the **BLACKWATER** Iraq Security Manager, Kuwait Security Manager or designated **BLACKWATER** Program Manager, **REGENCY** shall copy the **BLACKWATER** Director of Operations and the Deputy Director of Operations.

1.1.1.5 Continuous Ability to Field Operational Security Teams

BLACKWATER maintains the ability to field additional operational security teams organized to meet the ever changing security threats in the Territory in order to provide the most professional security services possible.

2.0 Support Solution

BLACKWATER's support solution is based on discussions with **REGENCY**, ESS Support Services management, and ESS Design and Build management's request to provide pricing on a per person support basis, not including costs for housing, subsistence, vehicles and large equipment items.

Security Organization Composition:

Type of Operator	Number
T1	2
T2	12
T3	20
Personnel Total	**34**

The following services and support items are the execution responsibility of BLACKWATER:

ITEM
Services
• Command & Control
o 24 x 7 Command Centers in Kuwait and Iraq to provide Command and Control of all security operations provided for ESS.
• Security & Threat Assessment
o Review of: ▪ Current security plans. ▪ Current contracts and standard contracting documents. ▪ Standard Operating Procedures (SOPs) ▪ Current Training Programs
o Site visits to all or planned ESS facilities located in Kuwait and Iraq. Site visits will include but not be limited to: ▪ Schedule and meet with each site's management personnel. ▪ Schedule and meet with each site's current security personnel and other key location personnel and organizations.
o Prepare a risk assessment based on accepted risk management principles. ▪ Develop a risk matrix. ▪ Recommend risk monitoring, training, and reporting plan options. ▪ Make recommendations for improvement of security operations.
o Develop Security Procedures and Evacuation Plans ▪ Staffing requirements ▪ Training needs and integration into the overall security strategy plan. ▪ Requirements for standardized operating procedures. ▪ Risk Management and Security Implementation strategies with Cost options
Planning Support • This will be in the form of route planning, movement of personnel, safety of ESS personnel, recommended safe housing areas, and other areas jointly agreed upon by ESS and REGENCY/BLACKWATER.
• Training for ESS personnel
o What to do when attacked during a convoy movement. Training for management personnel and workforce.
o Defensive Driving Class for managers working in Kuwait.
o Defensive Driving Class for ESS drivers going to Iraq.

ITEM
o Training courses to implement ESS Security Standard Operating Procedures.
o Threat briefings for Kuwait and Iraq. What to look for and techniques for safe movement within Kuwait.
o Medical refresher training in CPR and basic CPR training for ESS Managers
o Pre-deployment mission training
• Security Escort Teams
• Recovery Team: Recovery Teams will perform recovery of assets as required in a safe, timely and most feasible manner as deemed cost effective by **BLACKWATER** and ESS.
• Intelligence Information Program
o Intelligence Summary Bulletin fax and secure web site database updates
o BLACKWATER must provide REGENCY with daily intelligence reporting in electronic format for each physical location/area in which BLACKWATER is providing security services for ESS. There will be verbal briefings daily between designated ESS and BLACKWATER/ REGENCY representatives and weekly written or electronic assessments.
o Bi-weekly threat assessment briefing for ESS Management
Management Interface Methods
• Bi-weekly Assessment briefings
• Daily Program Manager Update/Interface
Administration
• Coordinate Iraq / US CPA issued weapons cards
• Training of **Blackwater** Personnel • Provide administration of the security program. This includes responsibility for interface with REGENCY personnel and staff and management and responsibility of BLACKWATER staff assigned to this contract. This function is to take care of all the personal and administrative needs of BLACKWATER staff that may arise, with REGENCY providing assistance when and where needed.

Table 1, Service and Support Items

2.1 Transition Plan

2.1.1 Phase I – Mobilization

- After payment of the Mobilization Payment set forth in Section 8.1.1., **BLACKWATER** will mobilize the agreed to security operation. Within twenty one (21) days, based on the following estimates **BLACKWATER** will:
  - Notice of award (NOA) +1: A planning and coordination Cell is activated in Kuwait and Iraq. Transition coordination begins with ESS management.
  - NOA-Day + 2: Initiate badging process for designated ESS personnel.
  - NOA-Day + 21: Effective start date of the effort.

2.1.2 Phase II – VIP / Staff Movement Operations

- Conduct security procedures training classes for ESS personnel being escorted to Iraq.
- Provide threat update briefings/bulletins and/or emails to ESS management personnel. This information will also be entered into databases supporting the secure web site, available 24x7. Procedures to be coordinated and developed with **REGENCY**.

- Provide protection and security escort services as required to ESS.
- Provide Security process improvement recommendations as required to ESS.

3.0 Security Personnel Vetting Process

Enlist United States citizens as qualified security personnel or non-United States citizens as qualified personnel, each with T1, T2 or T3 levels of experience (hereinafter collectively referred to as "Security Personnel"). Considering the level of skill and experience of **BLACKWATER** upon which ESS is relying to provide the Security Services, **BLACKWATER** shall, upon its own determination, when and where appropriate, enlist former NATO personnel with military special operations skills and experience. ESS will have the option of rejecting candidates presented for security of ESS personnel, after consultation with **REGENCY**, if ESS deems them inappropriate.

BLACKWATER will vet non-United States citizens to serve as "Security Personnel. The vetting of these non-United States citizens will be done as a planned event. BLACKWATER and REGENCY will mutually agree on a method to recover the costs of this vetting and recruitment process from ESS.

All **BLACKWATER** T1, T2, and T3 personnel go through an extensive vetting and pre-deployment vetting process as follows:

- Individual completes standard US government Standard Form 86, Application for security clearance.
- Individual submits resume along with US Department of Defense (DD) Form 214: Official Military Service Record summary.
- Background checks are conducted both with the former military service and National law enforcement authorities.
- Individual is retained.
- Individual goes through pre-deployment training. This pre-deployment training process is used to "weed out" any personnel who cannot pass our Team's physical, mental and emotional testing.
- Individual is re-qualified on their personal weapons, life saving techniques, defensive driving techniques and briefed on the current situation in Iraq.
- Individual is deployed.

APPENDIX B

Schedule of Rates, Supplies and Services

Table 1.

Item Number	Schedule of Supplies and Services	Unit	Unit Price	Quantity	Frequency	Amount
1	T1 Personnel	1	$ 1,075	2	365	$ 784,750
2	T2 Personnel	1	$ 945	12	365	$ 4,139,100
3	T3 Personnel	1	$ 815	20	365	$ 5,949,500
	Sub-Total			34		$10,873,350
4	Rotation Travel (See Note 1)	1	$ 3,500	34	1	$ 119,000
5	Miscellaneous	1	$89,976			$ 89,976
	Total Contract Value					$11,082,326
6	Mobilization Payment	1				$ 320,000
	Sub-total					$10,762,326
7	Monthly Estimated Invoice Base Includes items: 1,2,3,4,5					$896,860.50

Note:

1. The initial travel for the original thirty four Security Personnel mobilized to meet the requirements of this Agreement will be handled by BLACKWATER, with the cost covered in the mobilization payment at a rate of $3,500 (three thousand five hundred United States Dollars) per man per rotation.

   For the subsequent travel rotations (rotation 2 through 6 and thereafter) of Security personnel, REGENCY shall be responsible for travel rotations. In the event BLACKWATER has to pay for a travel rotation after the initial travel rotation, then BLACKWATER will invoice REGENCY at cost of the rotation plus 15% (fifteen percent) handling fee.
2. These rates do not include the cost of DBA insurance. These rates are subject to unforeseeable and uncontrollable events that may, upon mutual agreement of the parties to the Agreement, require adjustment.

Table 2.

Upon signing of this agreement, REGENCY will provide to BLACKWATER equipment for thirty four (34) personnel to include:

UNSPECIFIED

Item number	Quantity	Item Description
1	12	Vehicles, Security, with protection kit
2	12	Vehicle Emergency repair Kits
3	12	GPS for vehicles
4	12	Medical Kits for vehicles
5	12	Satellite Phone
6	12	GSM Phone
7	15	Vehicle Radio
8	2	Base Radio
9	2	Laptop and printer

ASSUMPTIONS
RHHC/BW REVISED PWC ASSUMPTIONS

1.01	Average number of outbound trucks a day = 130. This may increase and a contingency increases should be factored in to calculations. There is a minimum staffing of 130 trucks per day. Additional manpower can be added incrementally in whole team configurations to meet contingency increases.
1.02	Convoys up to 10 trucks will be escorted by minimum of 2 vehicles. There are 13 convoys per day composed of 10 vehicles each.
1.03	Convoys up to 20 trucks will be escorted by a minimum of 3 vehicles. Convoys up to 20 trucks will be escorted by a minimum of 4 vehicles.
1.04	Each escort vehicle will contain a minimum of 2 personnel. At least one vehicle in every convoy will contain 3 personnel. Additional manpower may be deployed based on the destination and the risk status at the time (intelligence gathering will be continuous process). Each escort team (2 vehicles) will contain a minimum of 5 personnel. Additional manpower will be added incrementally in whole team configurations
1.05	Personnel: PWC intends to utilize Iraqi nationals as much as feasible though led by experienced US or UK Nationals. An appropriate balance will be maintained on each outbound convoy. The balance of Western Expats to Iraqis will dramatically affect the total of the project. Iraqi nationals will be utilized to perform appropriate support functions at forward operating bases and to perform as interpreters (at least one per convoy). It is not feasible to obtain the high level of security and efficiency needed for this operation with embedded Iraqi nationals as security escort personnel due to cultural considerations.
1.06	Average Iraq transit time (target) for a return journey will be 8 days, though there will be possibilities of reducing this further. Agreed. Decreased transit times can be negotiated.
1.07	Cost should include the provision of all equipment required, escort personnel and support personnel both at PWC HQ in Kuwait and key hubs in Iraq. A command and control post(s) will be established inside Iraq. Agreed. Turn Key solution provided. — from client
1.08	Escort/security vehicles and personnel will be clearly differentiated both in terms of vehicle coloring and uniforms. The emphasis of the mission will be on achieving an effective deterrent and avoidance of confrontation. Flexibility to adjust and adapt to the situation. At all times the mission will be to achieve an effective deterrent, avoid confrontation and provide safety and security of the personnel and assets protected.
1.09	Clear rules of engagement will be defined, documented and agreed with the military and other concerned government agencies. Adherence to these rules will take top priority. Rules of engagement as currently defined, updated and amended by the US CPA in Iraq. Rules of engagement as currently defined, updated and amended by the Kuwait Ministry of Interior in Kuwait.
1.10	We envisaged a phased ramp up, focusing on DFACs in agreed geographical regions. The transition from military escort to private escort will be agreed against clearly defined time lines.

10	1	Power Point projector
11	2	Digital camera
12	4	GPS V (with charger)
	1	V-SAT or ADSL service, as appropriate. REGENCY will provide appropriate communication Service (V-Sat, ADSL) to BLACKWATER in Baghdad and Kuwait.
13	12	Heavy weapons
14	12	Heavy weapons ammunition 100rds/mo/man
15	6	AN PVS 9
16	6	PVS 14s Mono Scope with weapons

Table 3.

BLACKWATER is responsible for procuring and maintaining the items listed in Table 3.

1	34	Individual Personnel Weapons. The cost of these items is calculated into the per man per day rate listed in Table 1, Appendix
2	34	Personal weapons ammunition 500rds/mo/man. The cost of these items is calculated into the per man per day rate listed in Table 1, Appendix
3	38	Individual personnel Radio. BLACKWATER will invoice REGENCY for the cost of these items.
4	34	Individual personnel Body Armour. BLACKWATER will invoice REGENCY for the cost of these items.

Table 4.

For the addition of one T1, T2, T3 or T5 each individual is entitled to the following items in accordance with Tables 2 and 3 above:

Item number	Quantity	Item Description
1	1	Individual personnel weapon. The cost of these items is calculated into the per man per day rate listed in Table 1, Appendix.
2	1	Individual personnel ammunition 500rds/mo/man. The cost of these items is calculated into the per man per day rate listed in Table 1, Appendix
3	1	Individual personnel Body armour. BLACKWATER will invoice REGENCY for the cost of these items.
4	1	Individual personnel radio. BLACKWATER will invoice REGENCY for the cost of these items.

Table 5.

When a protection security detail unit (3 personnel and one vehicle) is added, the following items are included in accordance with Table 2 above:

Item number	Quantity	Item Description
1	1	Vehicles, Security
2	1	Vehicle Emergency repair Kits
3	1	GPS for vehicles
4	1	Medical Kits
5	1	Satellite Phone
6	1	GSM Phone
7	1	Vehicle Radio

Table 6.

Miscellaneous:
BLACKWATER will cover its internal Administrative Support requirements in Baghdad and Kuwait.

Item number	Quantity	Item Description
1	1	Administrative Support Baghdad
2	1	Administrative Support Kuwait

APPENDIX C

SAMPLE INVOICE

Actual invoice will be charged on actual numbers of T1's, T2's and T3's required according to the operational needs as outlined by **REGENCY**. As previously stated the amounts for the T1's, T2's and T3's is fixed for the duration of this contract with the number varying monthly.

ESS has agreed to provide housing and subsistence for the duration of this contract. There will be a 1/12th credit to **REGENCY** on the invoices for the first (12) twelve months of this agreement for the mobilization costs. Sample invoice shown below.

INVOICE

Item Number	Schedule of Supplies and Services	Unit	Unit Price	Quantity	Frequency	Amount
1	T1 Personnel	1	$ 1,075	2	30	$ 64,500
2	T2 Personnel	1	$ 945	12	30	$ 340,200
3	T3 Personnel	1	$ 815	20	30	$ 489,000
4	Subsistence (if needed)					
5	Rotation Travel					
6	Miscellaneous					
7	Credit Mobilization Payment	1				($26,666.66)
	Total Estimated Base Invoice					$867,033.34

LexisNexis

TRANSCRIPT EXCERTS

June 13, 2006 Tuesday
FDCH Political Transcripts

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

U.S. REPRESENTATIVE CHRISTOPHER SHAYS (R-CT) HOLDS A HEARING ON PRIVATE SECURITY FIRMS IN IRAQ

WITNESSES:

SHAY ASSAD, DIRECTOR, DEFENSE PROCUREMENT AND ACQUISITION POLICY, DOD
WILLIAM SOLIS, DIRECTOR OF DEFENSE CAPABILITIES AND MANAGEMENT, GAO
GREG STARR, DEPUTY ASSISTANT SECRETARY OF STATE
JAMES KUNDAR, ASSISTANT ADMINISTRATOR FOR THE NEAR EAST AND AFRICA, USAID

CHRIS TAYLOR, VICE PRESIDENT, BLACKWATER USA
MG ROBERT ROSENKRANZ (RET.), PRESIDENT OF INTERNATIONAL TECHNICAL SERVICE, DYNCORP INTL
IGNACIO BALDERAS, FORMER CEO AND CURRENT BOARD OF DIRECTORS MEMBER, TRIPLE CANOPY
DOUG BROOKS, PRESIDENT, INTERNATIONAL PEACE OPERATIONS ASSOCIATION
ALAN CHVOTKIN, SENIOR VICE PRESIDENT AND COUNSEL, PROFESSIONAL SERVICES COUNCIL

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WAXMAN: In my remarks today and in my questioning I will focus on this last issue: the burdens being placed on the taxpayers.

The costs of paying for an army of private security forces operating in Iraq is enormous, and it's one reason the reconstruction effort is failing. Rough estimates are that a quarter to a third of all reconstruction funding now goes to pay for security.

When an army sergeant provides a security detail, the taxpayers pay about $104 per day to cover his salary, housing and subsistence. But when a private contractor is hired to provide the same services, he can be paid up to $1,000 a day -- 10 times more. And due to tiering of security contracts, the final cost to the taxpayers may be far higher than $1,000 per day.

I wrote to General Jerome Johnson of the Army Field Support Command about this issue on November 30, 2004. We're here in June 2006. I raised the concern that under some contracts there appear to be as many as four layers of subcontractors between the taxpayer and the individual actually providing the security services.

As I explained in my letter, it appears that each contractor takes a cut of the profits, magnifying the cost to the taxpayer, but not offering anything of value. According to one account I cited, the final cost to the taxpayer could be inflated by 150 percent or more.

I asked specifically for a cost accounting that showed how much each tier a subcontractor was charging, but I also asked for copies of all the contract and subcontract documents to find out why this was happening. But the department would not provide the information. This is an intolerable situation.

The Bush administration is spending literally billions of dollars on private security contracts in Iraq. Yet when I ask a basic question about how much these services cost and whether the taxpayer is getting ripped off, I get stonewalled.

Maybe we have a chart we can hold up, just showing this example of tiering. We'll get that in a minute.

Because this hearing is about this issue, as a member of the committee, I am entitled to ask for a subpoena motion to get this information, because I think we're entitled to get the information. I've had a discussion with the chairman of the subcommittee. He

feels as I do, that the subcommittee and our committee is entitled to this information.

I could offer that motion, but that's not my purpose. I want to engage the chairman in a colloquy. As I understand it, you agree that we should get this information. You will join me in a request for the information. And we will use the full powers of this committee should that request not be granted in a reasonable period of time, to insist upon the information.

SHAYS: Well, my view is, very clearly, that when a committee requests information -- even when the minority requests it -- there should be a response. There should be a clear indication of what can be provided and what won't be.

My view is that this needs to be taken on by the full subcommittee. I will gladly help you get this information and join with you to get this information. And if we fail to get this information through the proper request in a very short period of time, then we would have to use the powers that are available to us to demand that information.

WAXMAN: And then you would support that, if necessary.

SHAYS: Absolutely. Absolutely.

WAXMAN: Well, I think that's an appropriate response, and one that I would very much welcome.

SHAYS: And I also want to express my disappointment that it has taken so long for this information to be provided.

WAXMAN: Thank you. Well, we've learned that we need to insist on accountability. And for that reason I'm very pleased that you are calling this hearing today.

I have other points I was going to make in my opening statement, but I will bring it in in the questions, because I think there is a better path than the one we've been following.

SHAYS: I thank the gentleman.

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SHAYS: I thank the gentleman very much, and would just point out, when members had left, Mr. Waxman had made a request that -- and as I read this letter, it is not a credit to DOD that they received the letter November 30, 2004, asking for basically the same kind of information, Mr. Duncan, you would want.

And they received a letter back from Johnson, who it was sent to, the commander of U.S. Army Field Support Command, basically saying he had referred the letter -- and this is dated December 21, 2004 -- he had referred the letter to the Office of Congressional Legislative Liaisons.

I just think it's very important for this committee to support that letter and that request for information. So this will be made part of the record, without objection. And the department will be very aware of what we're asking for. It was in your letter.

Mr. Waxman?

WAXMAN: Thank you, Mr. Chairman. I think you'll get more attention from them than, obviously, we did. And if we act together, we'll get the information that Congress is entitled to.

SHAYS: Well, it's a matter of legislative responsibility, and we do need to work together on that.

* * *

SHAYS: This hearing is called to order. Again, apologies for having to recess for a little bit for votes.

We'll start with Mr. Waxman, and I'll have questions. I prefer to ask mine towards the end.

So, Mr. Waxman, you have the floor. I think we will do a 10- minute round.

WAXMAN: Thank you, Mr. Chairman.

Mr. Assad, as you know, last year, GAO issued a report concluding that the Defense Department could not adequately determine how much it was spending on contractor security services. To address this deficiency, GAO recommended that the Defense Department track contractor security costs, and the Pentagon agreed to do this.

In order to gauge the Pentagon's progress over the past year, I want to focus today on just a single contract -- the biggest contract in Iraq -- which is the LOGCAP, the Army's contract for meals, housing and other logistical support for the troops.

Halliburton currently has this contract, which is now worth about $15 billion in Iraq alone.

What I'd like to know is this: How much of this $15 billion in LOGCAP funding went to pay for private security contractors?

ASSAD: Sir, Mr. Congressman, unfortunately, I don't have those details, but I will be happy to get that information for you and take it as a question for the record, sir.

WAXMAN: The Pentagon letter concurring with the GAO recommendations was signed by your office on July 19, 2005. And your letter says, "the Department of Defense will collect readily available data on incurred security costs under existing contracts." Those are the department's words.

This is a year later. Is it that you don't know how much U.S. taxpayers are spending for security under the biggest contract in Iraq, or you just don't have it with you today?

ASSAD: I just don't have that information with me today, Mr. Congressman.

WAXMAN: Didn't you think this might be asked?

ASSAD: On the LOGCAP contract?

WAXMAN: Yes.

ASSAD: No, I didn't, sir.

WAXMAN: I'd like to put up a chart, if I might. According to the investigative reports, security costs under Halliburton's LOGCAP contract have spawned multiple layers of subcontractors, all taking their cuts in successive rounds of markup. Let me walk through this.

According to the contract documents cited, the individual employee performing security services under this contract earned $600 a day, or $180,000 a year.

Blackwater USA, the company that employed this person, then tacked on a 36 percent markup. In addition to this amount, Blackwater also separately billed for all of its overhead and costs, including insurance, room, board, travel, weapons, vehicles, office space, administrative support and taxes. But it didn't end here.

Blackwater was a subcontractor to a Kuwaiti company called Regency Hotel, reportedly run by a retired U.S. Army officer. Regency was apparently billing up to $1,500 a day for that same single employee. But Regency was still not the top level. Regency was a subcontractor to a German company named ESS. We don't know how much ESS charged, but we do know that ESS was a subcontractor to Halliburton.

And we also know that Halliburton's contract with the Army guarantees that its costs will be fully reimbursed. So the contract, as we can see this layering of contracts here, guarantees Halliburton a fee of one percent of those costs, along with an opportunity for an additional two percent in award fees.

So, if this information is correct, the bottom line is that the U.S. taxpayer is paying hugely inflated prices for these services.

Mr. Assad, do you know whether this report is true? Are there really five tiers of contractors?

ASSAD: I do not, sir, but I will find out.

WAXMAN: All right. If we can cut to the bottom line, the biggest unknown here is the total amount of markup.

How much does Halliburton charge the American people for this $600 a day employee?

ASSAD: Mr. Congressman, I don't have that answer, but I definitely will look into it.

WAXMAN: Well, I'm asking, not for -- not a new question. I raised these in a letter to General Jerome Johnson of the Army Field Support Command on November 30, 2004. He wrote back saying that the Office of Secretary of Defense would provide a formal response.

The Defense Department has now had over a year-and-a-half to answer these basic questions. And the only conclusion I can draw is that there is a concerted effort to keep Congress and the American public in the dark. And since we're the people who pay the bills, that's simply not acceptable.

This goes to the questions that the chairman of the subcommittee is joining with me in asking, and we would like that information to be provided for us.

SHAYS: Would the gentleman just yield a second?

WAXMAN: Certainly.

SHAYS: Mr. Assad, in terms of looking into it, what we would want is a response...

ASSAD: Yes, sir.

SHAYS: ... in writing to these questions that the chairman has asked.

ASSAD: Yes, sir, Mr. Chairman.

SHAYS: Thank you. And that could be provided in the next two weeks?

ASSAD: I will make every attempt to do that, sir.

SHAYS: Thank you.

ASSAD: Yes, sir.

* * *

VAN HOLLEN: Thank you. Thank you, Mr. Chairman, and thank all of you gentlemen for your testimonies.

Well, as I said in my opening statement, I think that, clearly, there's an appropriate role for private security contractors in places like Iraq and elsewhere. The issue is exactly what functions and roles are being played, and what kind of oversight there is.

And it's my view that the United States government, the federal government, has a responsibility in making sure that the taxpayer is getting a fair treatment. It is the responsibility of the contractor to make sure you provide quality services under the contract, that you don't gouge the taxpayer.

But oversight from the federal government is important. And the federal government, it seems to me, should have a system set up to assure that the taxpayer gets the best deal.

And in that context, I would like to ask you, Mr. Taylor, just a couple of questions, because I think that the chart we've got here

today actually illustrates some of the problems with the overall system, from my perspective, in the cost plus with a percentage at the top.

Let me ask you first, are you familiar with the article that appeared in the "New Observer" several years ago that talked about the pricing structure for your company, for Blackwater USA? It was a couple of years ago. It was after the four individuals who were members of your company had been killed in Fallujah. And the newspaper wrote a story about that.

They also obtained information about the payments received from those four individuals.

Are you familiar with that?

TAYLOR: I am not, actually. It was an article -- understand, I read many things that are printed about our...

VAN HOLLEN: I understand. But that's just -- you know, that's the basis for a number of the charts -- the numbers on the charts Mr. Waxman presented.

My understanding is, a number of the family members of the people who got killed were upset about the fact that, despite the amount of money being charged the federal government and the taxpayer for these services, not enough was provided for security.

And that's the basis of the information. So, the information's wrong (ph) on these charts, is based on documents that were obtained by this newspaper about those particular individuals.

Now, I just want to make sure I understood your response to a question by Mr. Kucinich regarding the $815 a day charge. As I understand, you said that was fully loaded. Is that right?

TAYLOR: That's correct, sir.

VAN HOLLEN: OK. Because that article -- and this is an opportunity to correct the article, if you want. It said that the Blackwater charges to Regency for Zovko's work -- he was one of the individual contractors involved in that terrible incident -- were $815 a day, a markup of $215.

Then goes on to say, "in addition, Blackwater billed Regency separately for all its overhead and costs in Iraq, insurance, room and board, travel, weapons, ammunition, vehicles, office space."

In other words, they said that you billed separately for that overhead. And you're saying -- I just want to make it clear -- you're saying that that overhead was part of the $815 a day charge.

TAYLOR: I am told that the $815 was a fully burdened charge, sir.

VAN HOLLEN: If you could -- I don't know if you have documents. Just because the article was based on documents that were obtained through some people who had worked for Blackwater, and they reached a different conclusion. If you could provide the committee with those documents, it would be helpful.

TAYLOR: Again, I can certainly take that request back to legal counsel and...

SHAYS: No, let me just tell you this part, though, I mean, because you're on record. And I feel like I'm a friendly participant in this dialogue.

You're on record as saying that it basically constitutes the full force. So, you do need to document that, these $800 is the full cost of all the things that involve, the training, the housing, and so on.

And so, we just want documentation that shows that to be correct.

TAYLOR: Again, Congressman Shays, I will certainly go back to legal counsel...

SHAYS: No, no. But I'm trying to say it differently. I know you're going to go back.

TAYLOR: Yes.

SHAYS: I need to make sure that you provide us that information. Now, whether it's you that provides it or someone else, I just want to say, this is not an issue of, you know, you have the option to not provide that information.

Please tell your superiors that you have testified that -- and I believe you, so you don't have a problem with me -- that you have testified that this constitutes the full cost.

If it, in fact, doesn't, you need to set the record straight, that it doesn't, with documentation. And if it does, you need to just provide us the documentation that shows it's true.

It's a common request, and one to which I know you would -- you can't commit what your company does. I understand that. You're not the man in charge, but you're close to it.

So, that's all.

TAYLOR: I understand the request.

SHAYS: OK, good.

TAYLOR: Yes, sir.

SHAYS: And we understand what you're saying to us. Just as long as that gets conveyed to them.

TAYLOR: Absolutely.

SHAYS: Fair enough. Thanks. OK.

VAN HOLLEN: Thank you, Mr. Chairman.

Now, under this contract structure you have, as I understand it, if you could just look at that chart, Halliburton had the umbrella contract. Is that correct?

TAYLOR: I am not personally aware of that, sir.

VAN HOLLEN: OK. You were -- you did not know that at the top of this subcontracting pyramid was Halliburton?

TAYLOR: I am not personally aware of that, sir.

Chairman TOM DAVIS. Without objection.

Mr. VAN HOLLEN. Along with a contract that we found in the course of this investigation, with Blackwater, between Blackwater and Regency, that specifically outlines the conditions for hiring private security personnel. In fact, it says there are 34 vetted U.S. expat professional security personnel will form the core of the security organization that will support ESS operations.

So this raises a lot of questions, because if you look back at the contract, it specifically mentions that ESS is one of the subs to Kellogg, Brown and Root, and Halliburton. So on the one hand, we are doing an investigation to figure out what these private security contractors were costing the taxpayer, because it seemed to be lots of exorbitant costs.

In the process, according to the letter we received from the Army, we learned that in fact the Army never authorized Halliburton or any subcontractors from hiring private security. Is that right?

Ms. BALLARD. As I said, Congressman, the information stated in Secretary Harvey's letter is correct. I did verify that, in fact, again this morning before I came over to the Hill. But I will pursue answers to your questions.

Mr. VAN HOLLEN. Just in closing, Mr. Chairman, I just have two questions to leave with you. No. 1, was it authorized? And No. 2, did Halliburton get paid? Did the American taxpayer pay Halliburton for those private security services through that food chain on what is now said to be an unauthorized contract?

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you.

For more questions, we will go directly to Mr. Shays.

Mr. SHAYS. Thank you very much, Mr. Chairman, for holding this hearing. This is obviously not the first hearing you have held on Halliburton and others. This is generated by the Comptroller General who basically said Halliburton may be the catch-phrase, but there are a lot of other businesses that we should be looking into if we don't want to be political. So now we have a great opportunity.

I want to ask you, Ambassador Satterfield, first I want to say ditto to what my colleague said about your service and your candidness whenever we have interacted. I thank you for that.

I would like to know, you came in in 2004. When in 2004 did you come in?

Mr. SATTERFIELD. Mr. Chairman, I came in May 2005.

Mr. SHAYS. May 2005. OK. So a lot of this is looking back for you. You weren't there when it was happening. But when did the United States begin to have a sense that we were building Rolexes instead of Timexes, and maybe Timex was what they needed? In other words, we had some really big projects and yet there was a recognition that maybe we should have done smaller projects and just gotten a lot more done, and utilized Iraqis to do it instead of foreigners. When did that start to become evident to folks in Iraq?

Mr. SATTERFIELD. I can speak to the experience with which I am familiar, but I think it is generically the answer to your question. During the summer of 2005, particularly the period from June to August, we essentially worked, the military, General Casey, new Ambassador Khalilzad, and our respective teams, on examining all

aspects of the U.S. presence, mission, strategic goals, lines of operation, and action to achieve those goals, benchmarks, monitoring mechanisms to see how progress was being made, with an eye to exactly the sorts of issues that have been discussed today, not just on the development and project execution side, but also on the broader issues of political and security goals in the country.

As I outlined a moment ago to you, that was the approach we took. What was the strategic plan? What were the lines of operation and action needed to get there? What was the feasibility of those lines of operation and action based on realities as we saw them and could best assess them in Iraq? What were the benchmarks that you needed to put in place on all of these goals, on all the lines of operation? And what kind of monitoring mechanisms did you set up to ensure that the benchmarks were or were not being made? And if they weren't, what change in direction was necessary? Could you still achieve the same set of strategic goals?

That was a fundamental revamping of the way we did business in Iraq as a collective military-civilian mission. And the work was assisted very much in the ongoing flow of reporting, recommendations, assessments coming from the various oversight entities working in Iraq.

Mr. SHAYS. So did that mean that ended up stopping certain projects from continuing because there was an assessment that they just weren't meeting the objectives?

Mr. SATTERFIELD. It very much meant a review of contracting procedures, execution and projects.

Mr. SHAYS. I have a particular bias because having been there 14 times, the most memorable trips were when I stayed with Mercy Corps and stayed with children. These were non-government organizations that were given small dollars and they were then requested to help build schools and to do programs. What they did is, Save and Mercy Corps and others, they hired Iraqis to be within their own offices. And then these Iraqis hired Iraqis to do the job.

My understanding was, and I would like to know, Mr. Bowen, if you have reviewed that, that a lot of these projects got built and a lot of them are still standing.

Mr. BOWEN. You are right, Congressman Shays, there were other contracting approaches that succeeded, separate and apart from the design-build phase. General Corelli told me last week that there are six PHCs open and operating and they were built with CERP funds. He approved those allocations and, according to him as he represented, they are working.

So in our contracting lessons-learned report, the second recommendation in there is to find ways to institutionalize and carry forward alternate, more targeted contracting approaches, and indeed that has been the emphasis of the last year under Ambassador Khalilzad.

Mr. SHAYS. Thank you.

Mr. Bever, I saw you nodding your head. What is your sense about the choice of projects and whether we build them? Just weigh in on this. My time is ending, so just weigh in on how you would respond to the questions that I asked the others.

Mr. BEVER. Those particular projects you mentioned are under the Community Action Program, U.S. PVO's, fully audited, fully de-

pendable, who then sub-grant to all kinds of community organizations that in themselves also are subject to audit. We have had very, very good performance on those, with very low security costs, sir.

Mr. SHAYS. Mr. Chairman, I would like to just say to the Members of Congress, we reinstituted dollars, but not a lot, for this program. It has been one of the best. Projects have been built throughout Iraq. They are still standing. The Iraqis respect them. They built them themselves. It would be nice to see more of this activity being carried out.

I just want to ditto Mr. Lantos's comments about General Petraeus. He got it early on, but unfortunately there are people that replaced him who didn't.

Chairman TOM DAVIS. Thank you, Mr. Shays.

Mr. Kucinich.

Mr. KUCINICH. Thank you, Mr. Chairman.

Mr. Bowen, we have come a long way in this Congress from the days of $600 toilet seats. Now we have a $75 million building project that has been turned into a toilet. Are you going to have to tear those buildings down?

Mr. BOWEN. No, they are being refurbished as we speak. As I said, effective oversight has moved resources to remediate the problems at the Baghdad Police College.

Mr. KUCINICH. In the recommendations, you say you are going to perform a critical technical study of the structural integrity and load-carrying capacity. How can you say, if this report was just issued, that you are not going to have to rebuild those buildings?

Mr. BOWEN. Well, as I said earlier, the half-finished laundry will be torn down. The building next to it will be torn down. The assessment is critical, and I emphasized that to the Deputy Commander of the Gulf Region Division of the Corps of Engineers when I met with him a week ago. But from what my engineers tell me in reviewing that, while there will be a couple of buildings that will need to be torn down, the rest will require significant work to bring them to standard.

Mr. KUCINICH. Thank you. I have been looking at the statistics after listening to Mr. Lantos, and 32 percent of 14,121 school buildings rehabilitated or refurbished. Have all those been inspected to the degree that this has been inspected?

Mr. BOWEN. No.

Mr. KUCINICH. Note that, Mr. Chairman.

Four percent of 141 buildings with respect to health clinics have been completed; a $50 million hospital project ends up costing $170 million at least. When I am looking at these statistics, OK, this is the big leagues, right? It doesn't get any bigger than this. This is the big leagues. And when you look at these statistics, 32 percent of 114,121 school buildings rehabilitated or refurbished, and you say they haven't been inspected; 4 percent of 141 health clinics. This is the big leagues. The worst team in the big leagues has a 373 percentage. OK? This performance is not major league. It is bush league. And we have put the taxpayers' dollars at risk, and we have been given a measure of performance here that I think needs a little bit more explanation.

Now, Mr. Bowen, you had said in your testimony that your inspectors reported on projects that represent more than $308 million in contract value. Of this total, almost $250 million or 80 percent have met contract specifications. Now, you go on to concede these figures are not statistically significant, but let's put them into context of $30 billion in U.S. contracts; $20 billion in Iraqi funds. So you have a total of $50 billion in contracts, and $250 million of that has been reviewed and basically passed on. That is one-half of 1 percent. That is where we are, sports fans, major leaguers.

I want to raise another question here. Mr. Bowen, do you know where the infamous missing $9 billion in Iraqi funds has gone, for reconstruction?

Mr. BOWEN. Yes, sir. You are referring to my audit of January 30, 2005.

Mr. KUCINICH. I am just asking if you are looking for this $9 billion.

Mr. BOWEN. We are working with the Board of Supreme Audit to track the use of the DFI.

Mr. KUCINICH. "DFI," what do you mean?

Mr. BOWEN. Development Fund for Iraq, which is what that $9 billion was. That was not taxpayer dollars.

Mr. KUCINICH. No, but I want everyone to know for the record, that wasn't taxpayers' money. That was Iraqi money. OK, you made the point. Are you finding it?

Mr. BOWEN. I made the point that it was not taxpayers' dollars and it is Iraqi money, and that is why we are working with Dr. Abelo.

Mr. KUCINICH. Would you agree to a congressional request to see the Coalition Provisional Authority documents to determine what happened to the missing $9 billion?

Mr. BOWEN. Yes.

Mr. KUCINICH. Thank you.

Chairman TOM DAVIS. Thank you very much.

Who was next? Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman.

I thank the panel for being here. Let me start with Ms. Schinasi. I know for certain that mismanaged funds, your report on the uncover could go a long way in helping to rebuild New Orleans, or for that matter helping us in St. Louis, which I represent. I am especially disgusted because our domestic priorities are being ignored and States are struggling with budget cuts as this administration continues to allow billions of taxpayer dollars to be wasted year after year in Iraq.

Tell me, there has been over $50 billion in taxpayer money spent toward rebuilding Iraq with little to show for the money. According to your report, Pentagon auditors have challenged $3.5 billion in questionable charges from contractors. It is obvious that no one has been held accountable for wasting taxpayer dollars. What is the potential for criminal charges against individuals or corporations who have mismanaged these dollars? Has any of this information been turned over to the U.S. Attorney or Special Prosecutor?

Ms. SCHINASI. Congressman Clay, we have not seen evidence that we would believe needs to be turned over, and that is a question that we do——

Mr. CLAY. You don't think it needs to be turned over?

Ms. SCHINASI. We do turn over information to the Justice Department when we find it.

Mr. CLAY. You don't see anything criminal about ripping off taxpayers?

Ms. SCHINASI. We have not seen anything——

Mr. CLAY. You don't see that happening? Let me go to Mr. Tyler. Mr. Tyler, let me ask you.

Chairman TOM DAVIS. I think she answered that.

Mr. CLAY. Mr. Tyler, I am sorry. Mr. Tyler.

No, she didn't answer that.

Chairman TOM DAVIS. She said they didn't refer it.

Mr. CLAY. Fine, Mr. Chairman. Let me do my time, OK?

In March 2004, Parsons received a $500 million contract to rebuild hospitals, health clinics and buildings. After 2 years and wasting $186 million taxpayer dollars, they were found to be a poor contractor. Another Parsons contract for $99 million was terminated after 2 years for failure to complete prisons. Were any of these funds recouped or has the Inspector General found that the poor contractor performance delayed completion of the project and escalated costs?

Mr. TYLER. Sir, those contracts were managed. They were worked with Parsons. It has already been documented that there has been terminations I believe on all of those. And we are working to close the contracts out with Parsons, while we are working to finish the work through other contractual means.

Mr. CLAY. Have they been put on a list as a poor contractor, or not used again? Are you going to continue to use them? Maybe Ms. Ballard can answer?

Ms. BALLARD. Mr. Congressman, a contractor's past performance is in fact kept record of in the department, and it is used as an evaluation criteria in future acquisitions. Contractors' past performance is kept record of in the department and it is used as a basis for evaluation in future acquisitions.

Mr. CLAY. Let me ask Ambassador Satterfield, GAO reported that Halliburton contracts total $1.4 billion of the $3.5 billion in question in unsupported costs in Iraq contracts. It is unfortunate that a Halliburton representative is not present to answer my question. They have been proven to abuse taxpayer dollars again and again. Why does Halliburton continue to be granted Government contracts when they have been proven to be wasteful with taxpayer dollars?

Mr. SATTERFIELD. Congressman, we take very seriously the reports to which you refer. That is why we have supported the work of the GAO, of the Special Inspector, and the other auditing and accounting agencies and entities working in Iraq today.

Mr. CLAY. Have they been put on a poor contractor list? I mean, has anyone decided that these are the people that we need to protect our U.S. taxpayer dollars from?

Mr. SATTERFIELD. I am not aware of any such decision.

Mr. CLAY. Also, I ask you, Ambassador, the Washington Post recently revealed the administration's system of hiring, which you have heard already. A Frederick Smith, for example, was the Deputy Director of CPA. Do you know a Frederick Smith?

Mr. SATTERFIELD. No, Congressman, I do not.

Mr. CLAY. Well, he went on the record and explained that the key criterion for hiring people to serve in Iraq was that they had the right political credentials; that they probably worked in the Florida recount in 2000. Does anyone have any reason to believe that he is not telling the truth? Do you have a reason to believe he is not telling the truth?

Mr. SATTERFIELD. Congressman, I simply can't comment on those reports.

Mr. CLAY. Is he telling the truth?

Mr. SATTERFIELD. Congressman, I have no personal knowledge of these allegations. I can't comment on them.

Mr. CLAY. I thank you.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you.

Ms. Watson.

Ms. WATSON. I think that the expenditures of funds for reconstruction in Iraq are the best example we send to this country, to the taxpayers, and to the world of waste, fraud and abuse. We have been in Iraq for 3 years. We are trying to rebuild it. And I am looking at Parsons, I am looking at Halliburton. They have been paid off. They cut-and-run indeed, and they get paid cost-plus. Why has it taken us 3 years, and maybe we are to blame, Mr. Chairman, for not having oversight.

I was an ambassador. We had to report by cable to the Department of State almost on a daily basis. Our watch, if this kind of abuse occurred, we would have been out of there. I cannot understand the professionals sitting in front of us not giving us an outline on how we are going to correct it now. I find your answers to be really considering us as of low intelligence.

I am just going to say it. I am so frustrated sitting here, because the costs of this war is almost $400 taxpayer dollars, and we keep giving contracts out to people who cannot do the job. I think that if you can't tell me who has lost a job, who has been demoted, who had to step down for faulty planning, then you ought to step down.

I just want to say that our contracts and our reconstruction plans are opaque and with these no-bid and cost-plus contracts, we are ripping the people of Iraq, who we are trying to model a democratic government, and the taxpayers of the United States.

So I want some brave soul in the group to tell me what has been done constructively and what U.S. Government policies and procedures have been changed so that the chaos that has happened in Iraqi contracts will not happen again, and what Government officials, as I said before, have lost their jobs or been charged with crimes or malfeasance in regard to Iraqi contracting. Is there a brave soul among you that would like to respond?

Mr. BOWEN. Yes, ma'am. My office has 25 cases right now at the Department of Justice regarding wrongdoing. Five convictions have been attained from our investigations, four of them will be sentenced over the next few months. So I have 10 investigators in Iraq now pursuing 90 other cases.

And so yes, oversight is at work in Iraq, in Baghdad and across the country. I have 10 inspectors who virtually every week travel

outside the Green Zone and bring back reports like this, like the Baghdad Police College. And so yes, oversight is there.

Ms. WATSON. Let me interrupt you for a minute. Would you send your response to Congresswoman Diane Watson, 125 Cannon, as soon as we finish this hearing? I would appreciate that in writing. Be sure there is a date on it and that you sign it.

Mr. BOWEN. Yes, ma'am.

Ms. WATSON. Because I am going to hold it up.

I thank the Chair for having this hearing. We have to do more of it, because I have to go back to my district in Los Angeles and explain to them why we are spending the taxpayers' money the way we are as it relates to reconstruction. So I can hold your document up that we are catching the wrongdoers.

Thank you so much for having the courage to respond to me.

Mr. BOWEN. I will get you that answer today.

Ms. WATSON. Thank you.

Chairman TOM DAVIS. Make it available to the committee, too. I think we would all like to have it. Thank you very much.

The gentleman from Maryland?

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Ms. Schinasi, I want to thank you for being here. GAO issued a report on Monday regarding contracts in Iraq. Although we don't have a Pentagon auditor here today, we do have your report which is based on auditors' findings. I would just like to ask you a few questions.

First, the GAO found that the Pentagon auditors have now identified some $3.5 billion in questioned and unsupported costs under Iraq contracts. Is that right?

Ms SCHINASI. Yes, that is correct.

Mr. CUMMINGS. That is a stunning figure, and that is a much bigger figure than we have ever heard publicly. And your report discusses two types of charges. First, the auditors identified $2.1 billion in questioned costs. Is that right?

Ms. SCHINASI. Yes, that is correct.

Mr. CUMMINGS. The manual by the Pentagon auditors states that questioned costs are unreasonable costs in amount and exceed that which would be incurred by a prudent person. They recommend that these charges not be paid to the contractor. Is that right?

Ms. SCHINASI. Yes, sir.

Mr. CUMMINGS. Second, the auditors identify $1.4 billion in unsupported charges for which the contractor has not provided adequate documentation. Is that correct?

Ms. SCHINASI. Yes, sir.

Mr. CUMMINGS. Now, it seems, however, that the Pentagon isn't following the advice of its own auditors. Traditionally, the Pentagon upholds a majority of auditor findings and does not pay most questioned costs. Normally, the Pentagon refuses to pay contractors between 55 percent and 75 percent of the costs identified by auditors as questioned. They call this their sustention rate. Is that correct?

Ms. SCHINASI. Yes.

Mr. CUMMINGS. In your report, you identified some $386 million withheld from contractors in response to auditor recommendations. Is that correct?

Ms. SCHINASI. Yes, it is.

Mr. CUMMINGS. That was out of $1.4 billion. Is that correct?

Ms. SCHINASI. Yes, sir.

Mr. CUMMINGS. Now, that means that the Pentagon followed its auditors' recommendations only 27.5 percent of the time, or half the normal rate. Is that correct?

Ms. SCHINASI. Yes.

Mr. CUMMINGS. And why is that?

Ms. SCHINASI. One of the reasons that we identify in the report is this issue of beginning work before we agree with the contract on what they are going to do and how much we are going to pay them. And so what we found was that the contracting officers to whom the auditors report believe that they did not have the flexibility to get back costs that already had been incurred by the contractor.

Mr. CUMMINGS. Have we done anything to correct that situation? Or is there anything that can be done?

Ms. SCHINASI. As far as I am aware, as long as we have the undefinitized contract issue that we have, unless we give those contracting officers different directions than they appear to have been given, we will continue to see the same kinds of sustention rates.

Mr. CUMMINGS. Now, I won't ask you to comment on the causes behind this, but if my math is correct, $386 million was withheld out of $1.4 billion in charges identified by the Pentagon auditors as questioned. You are doing additional work on this issue, I understand, for the committee. Is that right?

Ms. SCHINASI. Yes, sir, for the chairman and the ranking member.

Mr. CUMMINGS. OK. And will you be able to break out for us the biggest contracts and tell us how much the auditors questioned, how much they identified as unsupported, and how much was actually withheld from contractors? Will that be a part of your report?

Ms. SCHINASI. We believe we will be able to do that.

Mr. CUMMINGS. Now, Ms. Ballard, let me turn to you for a moment. As I said, the Pentagon historically has followed its auditors' recommendations between 55 percent and 75 percent of the time, but now GAO says that you are following those recommendations only 27 percent of the time. Is that right?

Ms. SCHINASI. That is what the report says.

Mr. CUMMINGS. I can't hear you. I am sorry.

Ms. SCHINASI. That is what the report says, yes, sir.

Mr. CUMMINGS. OK. Do you agree with it or don't you?

Ms. SCHINASI. Our policy is that the contracting officers are responsible for investigating the questioned costs raised by DCAA. In that process, they are supposed to either determine if those costs are allowable and allocable and reasonable, or they are supposed to disallow those costs. That is the policy that we have.

Mr. CUMMINGS. Well, in May 2005, the committee received a briefing from the Pentagon auditors. We were told at that time that under the LOGCAP contract, the largest contract in Iraq, they had identified $813 million in questioned costs and $382 million in unsupported costs. Can you tell us today what the current figures are under the LOGCAP contract? And how much in questioned and unsupported costs have now been awarded to the contractor?

Ms. SCHINASI. I can tell you that today we have $468 million——

Mr. CUMMINGS. I am sorry, Mr. Chairman, I can't hear.

Ms. SCHINASI. We have $468 million in questioned costs today.

Mr. CUMMINGS. And what is happening with regard to that?

Ms. SCHINASI. We are working to determine if those costs should be recognized or disallowed.

Ms. SCHINASI. When costs are disallowed, I mean, I notice that like in Maryland, there is something called debarment. In other words, you can't contract anymore, and there are small contractors that are looking at this, looking at us on C–SPAN right now and they are listening to all these billions of dollars, and figuring out where they are going, and they are being debarred for small numbers compared to this. I was wondering, do we have such a mechanism in regard to this?

Ms. SCHINASI. The regulation does specify the circumstances under which we debar contractors. Usually that occurs when there is a criminal act on the part of the contractor and we comply with the regulatory guidance in following the process to determine if a contractor should be debarred.

Mr. CUMMINGS. Have we debarred anybody with regard to Iraq?

Ms. SCHINASI. Not to my knowledge.

[The prepared statement of Hon. Elijah E. Cummings follows:]

U.S. House of Representatives
109th Congress

Opening Statement

Representative Elijah E. Cummings, D-Maryland

Full Committee Hearing:
"Acquisition Under Duress: Reconstruction Contracting in Iraq"
Committee on Government Reform

September 28, 2006

Mr. Chairman,

Thank you for holding this vitally important hearing to examine reports of waste, fraud and abuse in Iraq reconstruction contracting.

This President's war has cost the American taxpayer an estimated $437 billion to date. And if the defense authorization conference committee report is approved, which is anticipated, and the Senate approves the FY2007 defense appropriations conference committee report, which the House approved on Tuesday, that cost will go up a projected $507 billion.

That figure is simply astounding. I think many would question whether the benefits outweigh the losses.

I do believe that we should provide our troops with necessary resources and invest in the rebuilding of Iraq. To be sure, I voted in favor of Tuesday's defense appropriation vote.

But when we start talking about spending hundreds of billions of taxpayer dollars, we have an obligation to ensure that those dollars are used as effectively and efficiently as possible.

Unfortunately, time and again, we have heard reports that this is not the case.

A culture of cronyism and cost-plus contracting prevails in Iraq reconstruction efforts, and it would seem that no amount of media reports, internal investigations, or Congressional oversight is capable of reversing this trend.

Finds of waste, fraud and abuse are plentiful:

- An article in this morning's *Washington Post* details a report by the Special Inspector General for Iraq, Stuart Bowen, who is with us today. The report finds gross mismanagement in a $75 million contract awarded to Parsons Corp., to build the largest police academy in Iraq.

- According to the article, the police academy was so poorly constructed that feces and urine rained from the ceilings in student barracks, floors heaved inches off the ground and cracked apart, and water dripped so profusely in one room that it was dubbed the "rain forest."

- Investigators fear that the academy is beyond repair, with its structural integrity in question, and public health concerns being raised.

Unfortunately, this scenario is not unprecedented. In total, Pentagon auditors have identified $3.5 billion in questionable and unsupported costs in Iraq reconstruction contracting.

- For one Halliburton contract alone—its $16.5 billion Logistics Civil Augmentation Program—the Defense Contract Audit Agency (DCAA) identified $1.1 billion in questionable costs.

- Halliburton whistleblowers have shed light on the company's deceitful practices, reporting that the company paid subcontractors up to $45 for a case of soda, and $100 for a 15-pound bag of laundry.

- And the IG in the past has reported that Parsons, despite spending $186 million of a $500 million contract to build hospitals and health clinics, had barely gotten the project off the ground, with just 20 of the 142 clinic completed.

The list of such reports is endless. And yet, these problems persist with relatively little oversight by this Congress.

We simply cannot, in good faith, justify to the American taxpayer this level of blatant waste, fraud and abuse in Iraq reconstruction contracting.

We have a duty as good stewards of public dollars to reverse this trend of cronyism and cost-plus contracting.

I look forward to the testimonies of today's witnesses and yield back the balance of my time.

Chairman TOM DAVIS. OK. The gentleman's time has expired.

Let me just take a couple more minutes on each side. Let me just ask Mrs. Schinasi, the way this works is the DCAA would come up and question costs, right, in their report?

Ms. SCHINASI. Yes.

Chairman TOM DAVIS. And that doesn't mean they are not allowable. That really starts the conversation whether it is allowable?

Ms. SCHINASI. Yes, that is correct.

Chairman TOM DAVIS. And then a settlement is reached. Is that correct?

Ms. SCHINASI. Yes, that is correct.

Chairman TOM DAVIS. So a DCAA questioning the cost doesn't per se mean that they are now allowable. They look at documentation and oftentimes the contractor will come back and have to either further document or explain what happens. Is that correct?

Ms. SCHINASI. Yes, that is correct.

Chairman TOM DAVIS. And we have asked you, have we not, to take a look at once this is done, and DCAA has questioned costs, and the contractors come in, and it is settled, we have asked you to come back and look at those settlements at the GAO and see if these settlements are within the ambit of what should be proper. Is that correct?

Ms. SCHINASI. Yes, and we are just starting that work now.

Chairman TOM DAVIS. I just wanted to make that clear because questioning the cost doesn't equal unallowability or mean that anything is necessarily wrong. In fact, I did this for 20 years previously. Many times, it is DCAA's job to question these things, but many times the contractor comes back and can show for good cause that it is not necessarily unallowable and that it was in fact proper. Sometimes they don't, but we have asked you to look at those settlements so the committee can then get further details in terms of how these are carried out and that there is no favoritism and try to answer those questions.

Mr. Van Hollen, I can give you a couple of minutes to followup. Thanks.

Mr. VAN HOLLEN. Thank you. Just a couple of things.

First, I was asking some questions earlier, Mr. Shays, about the subcommittee hearing we had a while ago where we went over some of the contracts, the Halliburton contracts. At that time, you may recall that we asked for, we were thinking about getting a subpoena, but instead you gave them 2 weeks to respond. We haven't, for the record, heard anything back from any of the folks either with respect to the documents on these cases.

Mr. SHAYS [presiding]. Let me do this. Let me research after the vote and tell you what we responded because I think the gentleman is primarily right, but let me fill in the details.

Mr. VAN HOLLEN. OK. I have the transcript from the hearing here, so I think we need to followup.

Mr. SHAYS. Yes, we will followup.

Mr. VAN HOLLEN. If I could just ask a question of any of the panel. This is a followup on the questions of political cronyism and to what extent they infected our efforts and the choice of people that we sent over for the reconstruction period. In the Washington Post story, they talked about a specific issue dealing with the pub-

lic health where they removed somebody and replaced him with a political appointee, essentially, named James Haveman. Mr. Haveman, according to the story, decided it was important to slash the list of drugs the Iraqi doctors could prescribe. In fact, a Navy pharmacist was brought in to come up with a new list, according to the story, and this Lieutenant Commander found that the existing list, "really wasn't that bad." And he told the Washington Post that Mr. Haveman and his advisors, "really didn't know what they were doing."

Are any of you personally familiar with this particular case and could you comment on why this person was brought in? With USAID, Mr. Bever, was this someone who was brought in under UsAID contract?

Mr. BEVER. Absolutely not, sir.

Mr. VAN HOLLEN. The person who had been there was with USAID.

Mr. BEVER. Absolutely, yes, sir.

Mr. VAN HOLLEN. And for the record, the person who you had as your expert was removed. Is that correct?

Mr. BEVER. Absolutely, yes. He was highly qualified, with a master's in public health and a highly experienced health officer, sir, in conflict situations.

Mr. VAN HOLLEN. I'm sorry?

Mr. BEVER. In conflict situations.

Mr. VAN HOLLEN. Yes, and the highly experienced person was removed in favor of a political appointee. Is that right?

Mr. BEVER. I can't comment on that. I don't know the details of that, but we can get an answer for you. We will try.

Mr. VAN HOLLEN. If you could please provide the details about how the decision was made to remove the expert with long experience under conflict situations, and replace him with someone with no experience in this kind of situation.

Mr. SHAYS. And you do agree that the person who came in did not have experience?

Mr. BEVER. I would have to research this more fully. I am generally aware of the press reports, but I have not seen the details and we want to make sure we have an accurate administration answer for you on this.

Mr. VAN HOLLEN. Thank you very much, Mr. Bever.

Mr. SHAYS. Thank you.

Mr. Bowen, I just want to make sure the record is clear. Whatever the record is, but when I constantly hear the reference to $9 billion missing, I am curious as to why you don't, or maybe you didn't feel you had the time, to share with us whether it is $9 billion missing, or whether it is an issue of billions missing, not $9 billion. My recollection is that dollars were given, say, to Generals to pay troops. They don't have a checking system, so dollars are given. Then the General gets those dollars and supposedly gives them to his troops.

But the real issue is that we don't have a paper trail of that $9 billion. Is that right?

Mr. BOWEN. That is right. I didn't get a chance to finish the point on this, but we have discussed it at previous hearings that you chaired. The core issue is that there was a lack of sufficient

controls to track how the money that was transferred from the CPA to that fledgling government of Iraq with ministries barely standing back up, and how they used that money. KPMG did audits on the Iraqi side. We just looked at what the U.S. controls were and they were inadequate.

Mr. SHAYS. The U.S. controls were?

Mr. BOWEN. Yes.

Mr. SHAYS. So we can't be certain of how much of the $9 billion that we had control of originally actually got to the Iraqis?

Mr. BOWEN. We know it got to the Iraqis, but we don't know how it was used.

Mr. SHAYS. But do we know, do we have a paper trail that says we gave certain dollars to certain Government officials.

Mr. BOWEN. Yes, we do.

Mr. SHAYS. Mr. Satterfield, you can answer, too, yes.

So the issue is, once it got into Iraqi hands, what happened to the $9 billion?

Mr. BOWEN. Right. Under UNSCA 1446, CPA was the de jure government of Iraq and had stewardship responsibilities, fiduciary I would venture to say, over the development fund for Iraq. Therefore, my criticism was fairly narrow. What was in place with respect to the transparency requirement was not sufficient to ensure full transparency.

Mr. SHAYS. So the bottom line is, though, this was dollars that we ultimately had a responsibility for because we were "the occupying Nation." They had the $9 billion to spend on their own, and the challenge is there is no paper trail to know how the Iraqis spent their own $9 billion. Is that correct?

Mr. BOWEN. That is correct. And the key point that I continually make whenever this issue comes up is that we did not say it was lost, stolen, or misappropriated. The finding in the audit was that there were insufficient controls to account for its use and the anecdotal investigation that we did on the Iraqi side of the ledger raised concerns.

Mr. SHAYS. I mean, huge concerns.

Mr. BOWEN. They were significant concerns, and indeed the corruption issue that Mr. Gutknecht addressed on the Iraqi side of the ledger is, while we don't draw the line, may be related to the fact that there was a very large sum of cash, all of it cash, transferred to fledgling ministries in 2003 and 2004.

Mr. SHAYS. Do the Iraqis have a checking account system now?

Mr. BOWEN. They do not have electronic funds transfer, and that continues to burden the management of money in Iraq.

Mr. SHAYS. Oh, it has to.

Is there any comment that any of you would like to make before we get to the next panel? Any other comments?

Let me thank you all for your service. I appreciate your being here today.

We stand at recess until the next panel.

Did you want to say something?

Mr. BOWEN. No. Thank you, Mr. Chairman.

Mr. SHAYS. Thank you.

[Recess.]

Chairman TOM DAVIS [presiding].

If we can get the witnesses in. Thank you for bearing with us. We have Mr. Earnest O. Robbins II, senior vice president of Parsons, I guess you drew the short straw today, and Cliff Mumm, the president of Bechtel Infrastructure Corp. Thank you for being with us.

It is our policy we swear you in. You just raise your right hand.

[Witnesses sworn.]

Chairman TOM DAVIS. Thank you very much.

Mr. Robbins, you can go first. I think you know the rules. We just appreciate your patience with us as we move through. Thank you.

STATEMENTS OF EARNEST O. ROBBINS II, SENIOR VICE PRESIDENT AND MANAGER, INTERNATIONAL DIVISION, PARSONS INFRASTRUCTURE AND TECHNOLOGY GROUP; AND CLIFF MUMM, PRESIDENT, BECHTEL INFRASTRUCTURE CORP.

STATEMENT OF EARNEST O. ROBBINS II

Mr. ROBBINS. Good afternoon, Mr. Chairman, members of the committee. I am Earnie Robbins, senior vice president of Parsons Infrastructure and Technology Group. I joined Parsons 3 years ago, and I serve as the manager of our Infrastructure and Technology Group's International Division. Management of Parsons' Iraq reconstruction projects fall under my division.

As you may be aware, the Coalition Provisional Authority divided the Iraqi reconstruction effort into six sectors. Parsons submitted proposals for several of those sectors, and in early 2004 was awarded design-build prime contracts in two of the six: security and justice, or S&J; and buildings, education and health [BEH].

Parsons understood there would be risk involved with these contracts, but many of the challenges could not have been foreseen. Before I explain the challenges and lessons that we have learned, let me first identify for you a few things that went right. I will focus on projects completed, our safety record, and our capacity-building contributions to the U.S. Government's reconstruction efforts.

We repaired or rebuilt several large Iraqi ministry facilities and judicial facilities. We repaired and improved 12 hospitals, constructed 119 border forts in far-flung, remote, often to the point of inaccessible locations. We built five border points of entry, constructed 54 fire stations, and even the public health clinic program, hospital renovations, prisons and the Baghdad Police Academy were on their way to having additional successes before the government issued termination notices.

We are also proud that Parsons consistently achieved safety metrics that exceed the average for companies performing similar construction within the United States. In the process, we constantly stressed the need for personal and collective safety on hazardous constructionsites.

Parsons successfully trained, educated and employed thousands of Iraqis. The Government required design-build prime contractors to provide measurable contributions to capacity building within the Iraqi private sector. This was defined as promoting the growth and

modernization of the Iraqi engineering and construction sector. Parsons aggressively met our responsibilities in this area from the earliest stages of our arrival in Iraq. For every U.S. engineer or related professional we deployed to manage these contracts, we hired approximately four Iraqi engineers, architects, planners, accountants, inspectors, schedulers and so forth.

At the high point of our presence in-country on these two contracts alone, we had 140 expatriate employees and 600 Iraqis working side by side with us. Through hands-on and classroom-type training, we introduced Iraqis to contemporary engineering and management processes and techniques, including U.S. approaches to project safety, quality control, contract administration, finance, design procedures and standards.

As noted by the Corps of Engineers and other Government agencies, the ability of some companies and individuals within the Iraqi engineering and construction community to absorb and particularly to apply Western ways of doing business proved to be problematic. The concepts of competitive contracting, transparent business practices, detailed documentation regarding invoices, and even rudimentary job-site safety were all alien to the majority of Iraqis we worked with.

Add the issue of security due to the rising tide of terrorism and sectarianism to the formula and the desired results became increasingly difficult for anyone, either Parsons or the Government, to attain. Despite our recognized achievements in capacity-building, we encountered a shortage of capable Iraqi managers and skilled craftsmen. This was particularly challenging given the sheer number of reconstruction projects simultaneously conducted as requested by the Government.

This leads me to a discussion of the challenges we did face. There were many unusual challenges, but I will mention three: sole definition of our contract scope; the impact of the deteriorating security situation; and the turnover among key Government staff.

At the time of the contract award, the Government did not know precise scope of work or even where it wanted many of the facilities to be located, and thus neither party knew the exact site conditions and could not accurately predict costs and schedules. Key factors such as this are typically known, or at least better understood prior to contract bid, award and execution. As mentioned by the GAO member of the preceding panel, this disconnect between requirements and available funding was always obvious. In some cases, it took up to 15 months for the Government to identify to Parsons what was to be built, where it was to be constructed, and what funding was available.

Again, I believe the GAO statement this morning summarized the impact of this issue. The delay in definitizing task orders significantly impacted both costs and schedule. A description of the situation can be found in various of the Special Inspector General's reports, including report No. 2 dated July 2006, in which the following statement is made: "By law, undefinitized task orders must be definitized within 180 days." The PMO/PCO usually did not meet this 180-day definitization deadline.

Even when we thought the scope of a particular project was definitized, we often continued to struggle with constant changes and interpretations regarding our contractual requirements.

The next challenge was security. As the Special IG has noted in previous reports, the presumption made by the Government and accepted by Parsons was that the security situation would be permissive. That environment simply did not materialize.

One aspect of our contracts with the Government-established measure of merit was hiring subcontractors. Iraqi construction companies performed all of the actual construction work under our management and supervision. We awarded over 1,700 subcontracts to Iraqi firms and at the peak of construction we had over 11,000 Iraqis employed on security and justice and medical projects. Even the day-to-day oversight of those Iraqi subcontractors was, as a result of cost and security concerns, conducted almost entirely by Iraqis hired and trained by Parsons.

Our reliance on Iraqi construction firms, and even to some extent, our dependence on Iraqis to assist us in managing those subcontractors made us extremely vulnerable to adverse schedule and cost impacts as the security situation deteriorated.

The third challenge I will address today was the well-documented and constant turnover of U.S. Government managers. This resulted in an endless stream of changes in priorities, expectations, direction and procedures. The results of these frequent changes are discussed in several of the Inspector General's reports. I would categorize them as counterproductive at best.

Finally, I want to address the inference made by some that Parsons walked away from the public healthcare clinics after completing only 20 of the 150 under contract. That is not accurate. The Government terminated us, our task orders for convenience. At that time, we had completed 20 of those PHCs with 35 additional clinics between 75 percent and 100 percent complete, and an additional 66 between 50 percent and 75 percent constructed. Parsons fully intended and wanted to complete those projects, but the Government apparently decided it could complete them faster and cheaper by other means.

In summary, we are proud of the role Parsons has played in assisting the U.S. Government and the Iraqi people in the reconstruction effort. The men and women who work for Parsons and for many other contractors present in Iraq have endured the daily danger, family separation, and lack of personal comfort and convenience that come with working in a combat zone, and they have for the most part received little credit or appreciation for doing so. When the final stories of the Iraq reconstruction are told, their efforts will hopefully be more objectively recognized and appreciated.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Robbins follows:]

House Committee on Government Reform Hearing

Acquisition Under Duress:

Reconstruction Contracting in Iraq

Statement by: Earnest O. Robbins II

Senior Vice President, Parsons

September 28, 2006

Good afternoon Mr. Chairman, Mr. Waxman, and Members of the Committee. I am Earnie Robbins, Senior Vice President of Parsons Infrastructure and Technology Group. I joined Parsons three years ago, and I serve as the Manager of our Infrastructure and Technology Group's International Division. Management of Parsons' Iraq Reconstruction projects falls under my Division.

As you may be aware, the Coalition Provisional Authority divided the Iraqi reconstruction effort into six Sectors. Parsons submitted proposals for several of these Sectors and in early 2004 was awarded Design-Build Prime Contracts in two of the six: Security & Justice (S&J); and Buildings/Education/Health (BEH). As the name implies, the awarded contracts involved two steps: first, to design the buildings and facilities, and second, to build or renovate them. As with all the Sector Design-Build reconstruction contracts, the Government awarded Parsons "Cost-Plus-Award-Fee" contracts. Quoting from The Government Contracts Reference Book, " Cost reimbursement contracts are typically used when the U.S. Government is unable to provide sufficient information for offerors to accurately determine a competitive price." Stating it another way, the Government typically uses cost-plus type contracts when the performance risks are high. Parsons understood there would be risk involved with these contracts but, as explained below, many of the challenges could not have been foreseen.

Before I explain the challenges and lessons learned, let me first identify for you what went right. I want to highlight three specific areas: our safety record; our hiring and training of Iraqis; and the projects we have completed.

Since contract award in March 2004, Parsons has exerted its best efforts to satisfy the requirements and expectations of the US Government. While no one can be pleased with the way some projects concluded, there are indeed many successes to be counted. We repaired or rebuilt several large Iraqi Ministry facilities and judicial facilities; repaired and improved 12 hospitals; constructed 119 border forts in far-flung, remote (to the point of almost inaccessible) locations; built 5 border Points of Entry; constructed 54 fire stations; and even the Public Health Clinic program was well on its way to having additional successes before the Government terminated for convenience the contract with just 20 facilities completed.

The Government, by contract, measured our safety performance. We are proud that Parsons consistently achieved safety metrics that exceed the average for companies performing construction within the United States. In the process, we constantly stressed the need for personal and collective safety on hazardous construction sites.

In addition to these "brick and mortar" achievements, Parsons successfully achieved another aspect of reconstruction; that is, the training, educating, and employing of Iraqis. The Government required Design-Build Prime Contractors to provide measurable contributions to "capacity building" within the Iraqi private sector. This was

defined as promoting the growth and modernization of the Iraqi engineering and construction sector, which had been in something of a technological and management time warp for several decades as a result of Saddam Hussein's corrupt and repressive regime. Parsons aggressively met our responsibilities in this area from the earliest stages of our arrival in Iraq. For every US engineer or related professional we deployed to manage these contracts, we hired approximately four Iraqi engineers, architects, planners, accountants, inspectors, or schedulers. At the high point of our presence in-country on these two contracts, we had 140 expatriate employees and 600 Iraqis working side-by-side with us. Through hands-on and classroom-type training, we introduced Iraqis to contemporary engineering and management processes and techniques, including US approaches to project safety, quality control, contract administration, finance, design procedures and standards.

As noted by the Corps of Engineers and other Government agencies, the ability of some segments and individuals within the Iraqi engineering and construction communities to absorb and, particularly, to apply these Western ways of doing business proved to be problematic. The concepts of competitive contracting, transparent business practices, detailed documentation regarding invoices, and even rudimentary job-site safety were all alien to the majority of Iraqis. Add the issues of personal security due to the rising tide of terrorism and sectarianism to the formula, and the desired results became increasingly difficult for anyone, either Parsons or the Government, to attain. Despite our recognized achievements in "capacity building," we encountered a shortage of Iraqi managers and skilled craftsmen. This was particularly challenging given the

sheer number of reconstruction projects simultaneously conducted, as requested by the Government.

This leads me to a discussion of challenges we faced. The first problem was the time and difficulty it took to definitize the contracts. At the time of contract award, the Government did not know where it wanted many of the facilities to be located, and thus neither party knew of the site conditions. Key factors such as this are typically known, or at least better understood, prior to contract bid, award and execution. In some cases it took up to 15 months for the Government to identify to Parsons what was to be built, where it was to be constructed, and what funding was available.

The delays in definitizing the Task Orders, significantly impacted both costs and schedule. A clear description of this situation can be found in various of the Special Inspector General's reports, including Report #2 dated July 2006, in which the following statement is made: "....by law, undefinitized task orders must be definitized within 180 days. PMO/PCO usually did not meet this 180-day definitization deadline..." Even when we thought the scope of a particular project was definitized, for reasons described below, we continued to struggle with constant changes and interpretations to requirements.

The next challenge was security. Another aspect of our contracts which the US Government established as a measure of merit was the hiring of Iraqi subcontractors. Iraqi construction companies performed virtually all of the actual construction work, under our management and supervision. We awarded over 1,700 subcontracts to Iraqi

firms, and at the peak of construction we had over 11,000 Iraqis employed on Security and Justice and BEH projects. Even the day-to-day oversight of those Iraqi subcontractors was, as a result of cost and security reasons, conducted almost entirely by Iraqis hired and trained by Parsons.

As the Corps of Engineers, the Inspector General, various other Government agencies, and the media have noted, the reconstruction efforts in Iraq have encountered many problems from the outset. In the case of our two Design-Build contracts, the challenges far surpassed anything predicted. It is with deep regret and frustration that these projects could not be finished as intended.

The Government's requirement that we rely on Iraqi construction firms and even, to some extent, our required dependency on Iraqis to assist us in managing those subcontractors, made us extremely vulnerable to adverse schedule and cost impacts as the security situation deteriorated. As the Special IG has noted in previous reports, the presumption made by the Government and accepted by Parsons was that the security situation would be "permissive." That environment simply did not materialize. Our subcontractors and our Iraqi staff were subject to constant threats of injury or even death, to themselves and their families, and our US national employees who also lived and worked under extreme duress. One of our Iraqi task managers was murdered on site. Our materials were stolen with demands that we pay ransom for their return. We had to negotiate with tribal leaders to secure laborers and to ensure "protection" at the work site. Our management team of expatriates and Iraqis were subjected to increasing danger when

traveling to job sites, as well as when living and working in the International Zone, where there were direct hits by rocket fire on our office and living accommodations. Despite all these challenges, we made progress and exerted our best effort to get the job done without sacrificing the safety of our employees, both expatriates and Iraqis.

The third challenge I will address today was the well-documented and constant turnover of US Government managers. This resulted in an endless stream of changes in priorities, expectations, direction, and procedures. We experienced frequent scope and schedule changes from the Government without any willingness to increase the funding.

Finally, I want to address the inference made by some that Parsons "walked away" from the Public Healthcare Clinics (PHCs) after completing only 20 of the 150 under contract. That is not accurate. The Government terminated our task orders for convenience. At that time, we had completed twenty PHCs, with 35 additional clinics between 75-100% complete, and an additional 66 between 50-75% constructed.

Parsons wanted to complete these projects, but the U.S. Government apparently decided it could complete them faster and cheaper by other means, including in some cases direct contracts to the same subcontractors Parsons had employed.

In summary, we are proud of the role Parsons has played in assisting the US Government and the Iraqi people in the reconstruction effort. The men and women who worked for Parsons and for many other contractors present in Iraq have endured the daily

danger, family separation, and lack of personal comfort and convenience that come with working in a combat zone, and they have, for the most part, received little credit or appreciation for doing so. When the final stories of the Iraq reconstruction are told, their efforts will hopefully be more objectively recognized and appreciated.

Chairman TOM DAVIS. Thank you very much, Mr. Robbins.

Mr. Mumm.

STATEMENT OF CLIFF MUMM

Mr. MUMM. Good afternoon, Mr. Chairman and members, and thank you for this opportunity to appear before this committee.

My name is Cliff Mumm. From April 2003 through December 2004, I was the chief of party of the USAID Iraq Reconstruction Project. During that period, I lived in Iraq. I lived and slept in Iraq. I maintain ongoing executive responsibility for the USAID-Bechtel work in Iraq and I continue to travel back and forth to Iraq frequently.

Bechtel won two competitive contracts from USAID to cover the restoration of essential power, water, civil and telecommunications infrastructure. It did not, neither of the contracts, included oil or gas sectors. Under my direction, Bechtel delivered its first team to the region within 3 days of winning the contract.

One of our first priorities, and in those days you could travel because the security situation was such that it allowed it, was to crisscross the country and assess the state of Iraq's infrastructure so USAID and the U.S. Government could make a determination of the highest priority needs.

In addition to war damage, our teams discovered that many critical facilities such as water treatment and power plants, had been wrecked by years of neglect, looting, and ministry mismanagement. Our assessment concluded that approximately $15 billion was needed to bring that country up to some regional standard. Given the country's vast needs, no one expected that our contracts, which totaled $2.3 billion, could complete the job. The work under those contracts could and did, however, provide a platform upon which the Iraqis could build and sustain themselves.

To help get the country back on its feet, we used Iraqi contractors every place we could. In fact, we awarded to Iraqi contractors three-quarters of our work, and anyplace we didn't award to Iraqi contractors, such as power suppliers, we required in their contract that they award to Iraqi contractors. At peak, our work employed 40,000 Iraqis across the country.

Among other accomplishments, we dredged and refurbished Iraq's only deepwater port of Umm Qasr, which hadn't been opened since the Iran-Iraq War. We restored the bulk of Iraq's water treatment and sewage treatment capacity, which is capable of serving millions of people. Our work in the power sector increased capacity by more than 1,200 megawatts.

Hundreds of thousands of Iraqi children were able to attend classes in 2003 in more than 1,200 schools we refurbished. We repaired three major bridges for humanitarian and commercial traffic, and we also restored the national telecommunications grid.

One of our most important contributions was in institutional strengthening. More than 600,000 hours of training programs were provided by Bechtel, which improved Iraqi skills in plant operations, in plant safety, construction management, and information technology.

The security environment we encountered in Iraq was profoundly difficult. Armed insurgents stop at nothing to sabotage major infra-

structures. Key Iraqi operating staff are often forced to abandon their posts in the face of murder and kidnaping. And power generation is often stranded when fuel pipelines are blown up or transmission lines cut.

In the case of the Basrah Children's Hospital, escalating violence frequently made work impossible. In May 2006 alone, 85 people were murdered in Basrah, including nine British soldiers. Iraq's Prime Minister declared a state of emergency in the city and that state continues to today.

In the face of all of this, our team still managed to complete the essential civil and structural work for the hospital, leaving it in the good condition that it is today for future consideration.

We are proud of the work we did in Iraq on behalf of the American and the Iraqi people. We are also proud of our own people, including the over 600 professional Iraqi colleagues. USAID has attested that Bechtel performed exceptionally well under extremely difficult circumstances.

I am honored to share my experience with you this morning, and look forward to questions.

Thank you.

[The prepared statement of Mr. Mumm follows:]

Statement of
Cliff Mumm
President Bechtel Infrastructure Corporation
Bechtel Corporation
Committee on Government Reform
U.S. House of Representatives

September 28, 2006

IRAQ INFRASTRUCTURE RECONSTRUCTION PROGRAM

On February 12, 2003, as the likelihood of conflict grew, the U.S. Agency for International Development (USAID) issued an urgent Request for Proposal (RFP) to six leading U.S. contractors for emergency rebuilding work in Iraq. The contractors, including Bechtel, were prequalified on the basis of their proven capacity to undertake nationwide repairs of civilian infrastructure and their ability to comply with complex federal regulations.[1]

Bechtel, which had built major facilities throughout the Middle East for 60 years and had managed the multinational effort to extinguish hundreds of oil fires and restore Kuwait's oil industry after the Gulf War, won the competitive bid. USAID announced its 18-month, $680 million cost-plus-fixed-fee contract for the Iraq Infrastructure Reconstruction Project on April 17, after the fall of Saddam. Political controversy over the conflict with Iraq spilled over to USAID's contract award, eliciting ill-founded but widely publicized charges of political favoritism and sweetheart "no-bid" contracts. USAID Administrator Andrew Natsios refuted such charges during a national news interview:

> There was no political involvement by anybody in AID on choosing who the companies were. . . . It was done by career officers based on the merits of which companies have worked with us before through Democratic and Republican administrations. . . . [Bechtel] had the highest quality rating, highest score, for the technical requirements of the project and the lowest price. That is the ideal for federal contractors. We almost never get it that good, where we have the highest score for the technical and engineering side of it and the lowest price of the bids that were made.[2]

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[1] USAID explained its choice of procedures as follows: "As the U.S. Government's first responder to foreign emergencies, disasters and humanitarian crises, USAID undertakes contingency planning for . . . relief and reconstruction scenarios in all corners of the developing world. In the case of Iraq, USAID made the determination that it could very well be called upon at any time to deliver assistance rapidly in order to meet various contingencies. At that point, USAID decided to undertake specific procurement planning actions, but did not want to do anything that might have complicated diplomatic efforts to prevent war. Therefore, contract negotiations had to be conducted on a sensitive and expedited basis. Events have confirmed that these contracts needed to be awarded and available for use as soon as possible. . . . USAID chose to limit competition -- in full compliance with the Federal Acquisition Regulations -- for these Iraq reconstruction contracts to certain U.S. companies that are known to have a combination of demonstrated technical capability, proven accounting mechanisms, ability to field a qualified technical team on short notice or the requisite clearance to handle classified national security material. This was done in accordance with existing regulations . . . when it is necessary to move forward quickly with foreign assistance programs." (USAID statement, April 11, 2003)

[2] ABC Nightline, April 23, 2003.

A monumental task

Although the initial contract was modest, the potential scope of the project was enormous, posing exceptional challenges even to a company as experienced as ours. Our job was to help return basic services to pre-war levels as quickly as possible by recruiting and managing skilled teams of international and Iraqi subcontractors to repair or reconstruct key facilities. Based on specific job orders approved by USAID, sectors of work included power production and transmission facilities; water, irrigation, and sewage systems; transportation links including airports, railways, and roads; telecommunications infrastructure; and civilian buildings such as hospitals and schools. The task was monumental, but essential to helping Iraqis resume a normal day-to-day existence and to stabilizing and strengthening Iraq's economy.

Bechtel hit the ground running, mobilizing its first team in the region only three days after the contract award. I was the first program director. I was aided by Deputy Program Director Terry Valenzano and an initial team of about two dozen seasoned Bechtel employees.

Assessing the damage

Upon arriving in Iraq, we discovered many of the infrastructure surveys that were to be performed by USAID and other agencies had not been started. Bechtel took on the responsibility for identifying key contacts, assessing current infrastructure conditions and establishing requirements for rehabilitation. The goal was to help USAID set priorities based on a sophisticated understanding of Iraq's interrelated needs and capabilities, rather than pursuing showcase projects that might have little practical value.

Bechtel's fact-finding teams criss-crossed the country, checking high-voltage transmission towers and lines, inspecting water treatment facilities, and documenting the damage to airports, bridges, and other buildings. They found abundant evidence of war damage (bombed out bridges and telephone exchanges); power and water facilities that were far more dilapidated than anyone expected due to years of neglect; and rampant looting by thieves and saboteurs who stripped power substations and transmission lines across the country of valuable parts and copper wire, leaving them a shambles. [3]

Based on these observations and other data, Bechtel completed a 151-page assessment and implementation plan for seven key infrastructure areas in June 2003. USAID and the Coalition Provisional Authority (CPA) approved the plan in July 2003. Projects were largely drawn from the initial assessment, but USAID amended the scope of work under each job order as required to meet evolving needs and the reality on the ground.

No one assumed that $680 million, the cost of building a medium-sized power plant in the United States, represented more than a small down payment on Iraq's vast infrastructure needs. Paul Bremer, the CPA's administrator, said in July 2003 that "getting the country up and running again" could cost as much as $100 billion.[4] Bechtel's estimate of the cost to complete all work identified in our assessment—not including renovation of oil infrastructure or many other sectors—was $15 billion.

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[3] When Bechtel first surveyed Iraq's electrical transmission system in May 2003, we observed thirteen destroyed towers. By September, a survey by the U.S. Army Corps of Engineers tallied 623 destroyed transmission towers. At one point, saboteurs cut all four electrical transmission lines running to Basrah's refinery, making the country run short of fuel supplies and causing riots in the city.

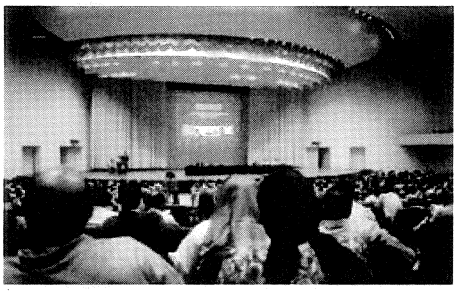
[4] Associated Press, August 11, 2003.

In contrast, the total value of Bechtel's work over four years was less than one-sixth of that figure, about $2.34 billion. USAID increased Bechtel's Phase I contract from $680 million to $1.03 billion over the course of our work. Bechtel later won (January 2004) a competitively bid Phase II USAID contract from a field of four bidders. The second contract was worth up to $1.8 billion that is currently on track to finish at approximately $1.31 billion.

Even at this early stage, Bechtel realized that security would be a critical issue determining how much work could be accomplished on USAID's budget. Bechtel's contract with USAID specified that our work would take place in a "permissive" or non-threatening environment. We highlighted the challenges in our June 2003 assessment report:

> Due to the instability of the security situation in Iraq, a strict security regime has been imposed upon the Bechtel assessment teams. The requirement to be in a safe location before nightfall, and to have military or other security protection as our teams travel, has resulted in an inability to conduct assessments as quickly and as easily as anticipated. This has also added cost and complexity to the assessment process.
>
> Looting and vandalism continue unabated in many areas of Iraq . . . . The armed theft of a crimping machine, the recent break-in at warehouses at the Port of Umm Qasr, [and] the ongoing destruction of 400 kV transmission towers in southeastern Iraq . . . are a few examples of this situation. . . . In addition, the validity of the assessment becomes compromised when additional damage occurs after the assessment team has completed its review.[5]

Recruiting Iraqis



Iraqis attending Baghdad supplier and contractor conference

To manage the unprecedented interest in our reconstruction work, Bechtel set up a Web portal to register suppliers and subcontractors with experience in the region and in relevant construction fields. Bechtel also held five conferences in Washington, D.C.; London; Kuwait City; Baghdad; and Basrah to inform potential suppliers and contractors about work opportunities and federal rules and regulations. Bechtel registered more than 9,200 contractors from 96 countries in less than four months.

With USAID's full endorsement, Bechtel focused on identifying and supporting qualified Iraqi subcontractors whenever possible. Their experience and local knowledge was invaluable in getting the job done. Just as important, recruiting them to perform the work would advance the U.S. government's larger goal of hastening Iraq's economic recovery through increased employment.

Over 1,300 Iraqis attended Bechtel's supplier and contractor conferences in Baghdad and Basrah the first summer. Over the life of the project, Iraqi subcontractors performed about 75 percent of the work. At peak, Bechtel's projects employed 40,000 Iraqi workers. Bechtel also trained and employed more than 600 Iraqi nationals on its professional staff over the course of the program. Bechtel typically maintained a 4:1 ratio of Iraqis to Bechtel expatriates on its Iraq project staff.

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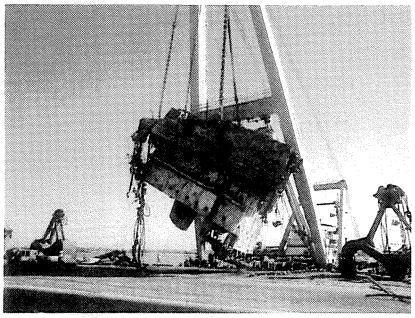
[5] Bechtel National Inc., *Iraq Infrastructure Reconstruction Program: Assessment Report*, June 2003, p. 1.15.

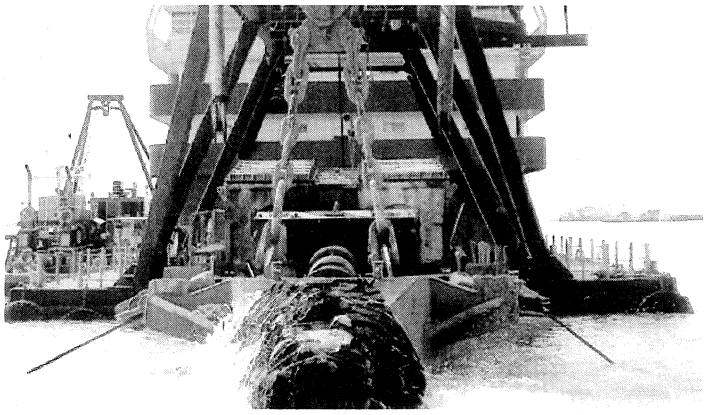
Port of Umm Qasr



Removing Wreck From The Port Of Umm Qasr

Grain Facility At Umm Qasr

Less than three weeks after the contract was awarded, even while the nationwide assessment was continuing, Bechtel began emergency dredging of Iraq's only deepwater port, at Umm Qasr. With bridges and railroads damaged or dilapidated, reopening the port was critical to importing food and other emergency supplies. The first shipment of rice from the United States arrived on May 2, after a Bechtel survey ensured the berth could handle the ship and its 14,000-ton cargo. By June 16, with more than a million cubic meters of silt and debris dredged, the port began accepting commercial traffic. Bechtel also restored support services (power, water, sewage, administration) and oversaw the renovation of the port's facilities to handle more than 600 metric tons of grain imports per hour.

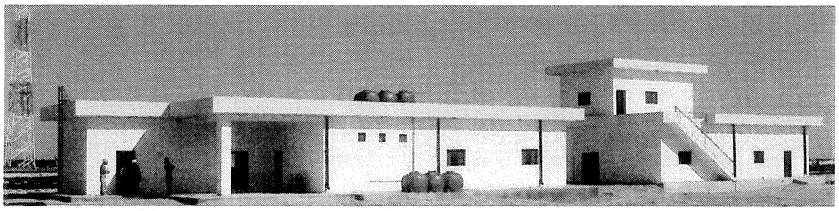


The dredger 'Carolina' In The Port Of Umm Qasr

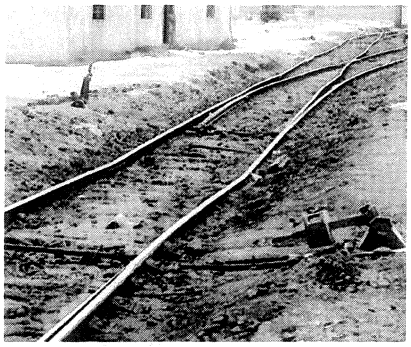
Railroads

To ship food and other vital supplies from Umm Qasr, Bechtel worked with Iraqi Republic Railways repair or selected fixed and mobile railroad infrastructure, including critical track bed sections, rail bridges, stations, locomotives, and rolling stock. Bechtel built 57 kilometers of roadbed and 29 concrete culverts between Umm Qasr Port and Al Shuiaba Junction in Basrah.

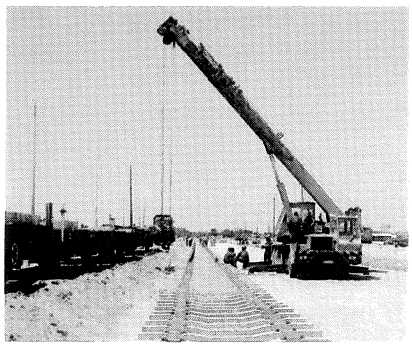
Typical Rail Station Before



Typical Rail Station After



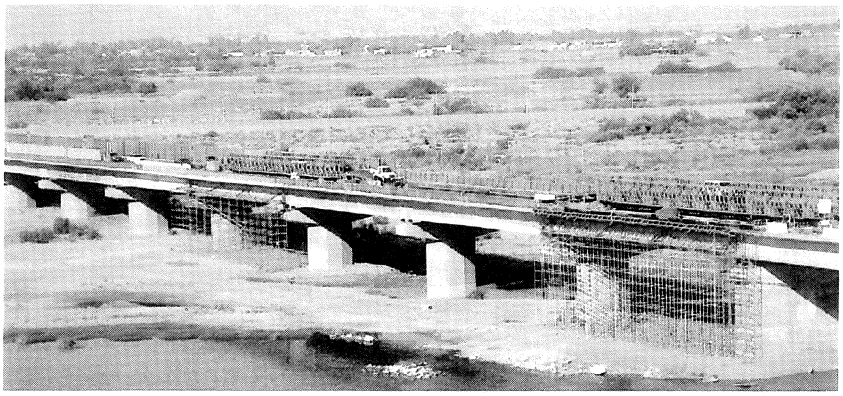
Damaged Track



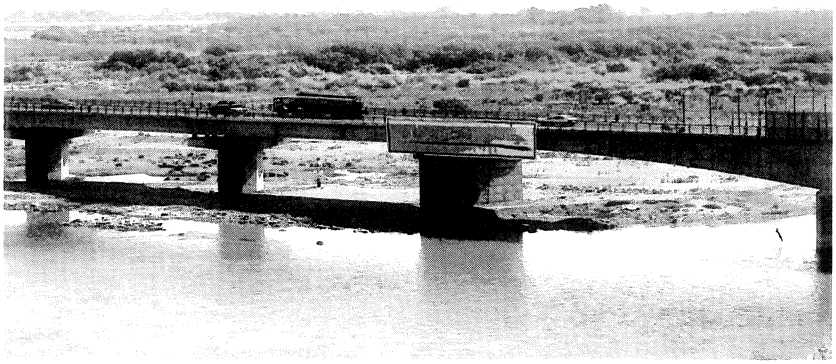
Laying New Track

Bridges

By mid-July 2003, Bechtel had completed its first construction project: a bypass around the damaged Al Mat Bridge, 185 miles west of Baghdad. The war-damaged bridge was an important link in east-west transportation; 3,000 trucks traveled daily on Highway 10, bringing food and other goods from Jordan to Baghdad. Bechtel's Iraqi subcontractors later rebuilt the bridge and two others at Tikrit and Khazir, at USAID's direction.



Tikrit Bridge Early in Construction



Tikrit Bridge Complete – Banner Reads "Bridge For Future Progress"

Airports

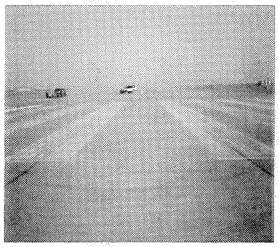
USAID placed high priority on the rehabilitation of the Baghdad and Basrah airports due to their importance as gateways for relief and reconstruction supplies and personnel. Bechtel was assigned task orders to restore them as needed to permit limited civil air traffic services.

The work scope included installing perimeter and airfield fencing; providing water and sewage treatment plants; applying runway and taxiway striping; purchasing and installing communication systems; rehabilitating emergency power and HVAC systems; and repairing support facilities (terminals, control towers, etc). Thanks in part to this work:

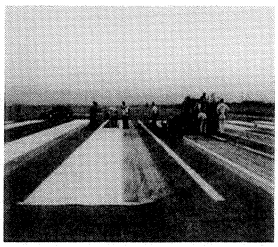
- Baghdad International Airport reopened for commercial service in July 2003 and passenger service on August 25, 2004.
- Basrah International Airport reopened for passenger service on February 13, 2006.

Baghdad International Airport passenger terminal completed

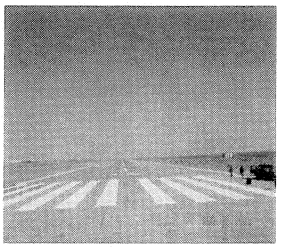
Baghdad International Airport roof damage



Before



During



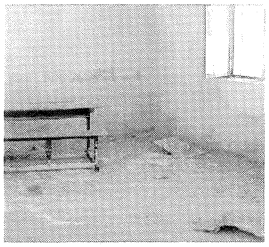
After

Baghdad International Airport Runway Striping

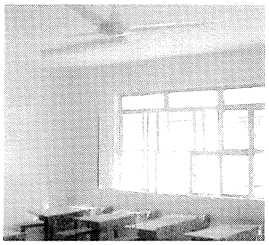
Buildings: schools, clinics, fire stations

USAID (and the Coalition Provisional Administration) assigned great significance to reopening schools and tasked Bechtel with repairing them as fast as possible over the summer of 2003. The schools were generally sound and required little structural rehabilitation to make them fully functional. However, decades of neglect, looting, and vandalism resulted in long backlog of architectural, electrical, and plumbing repairs. Also included in Bechtel's scope was the task of detecting and removing unexploded ordnance from schools, which in had often been used to store munitions. Although the work at individual school sites was otherwise mundane, the major organizational challenge was to find qualified Iraqi contractors to complete work on a large number of schools within a few months.

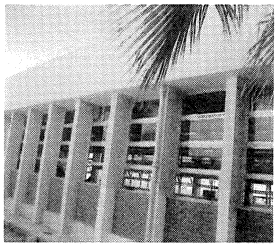
In all, Bechtel restored 1,239 schools by October 2, 2003, in time for the start of the new school year. Bechtel also restored 52 medical clinics, 10 fire stations, repaired the University of Basrah's Materials Testing Laboratory and made significant progress on a new children's hospital in Basrah (see appendix).



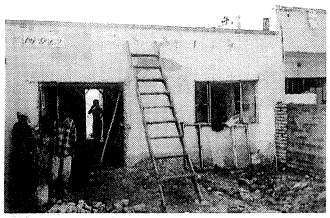
Typical Classroom Before Restoration

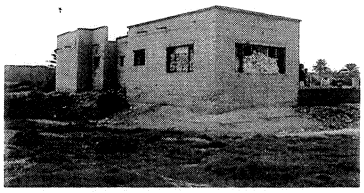


Typical Classroom After Restoration

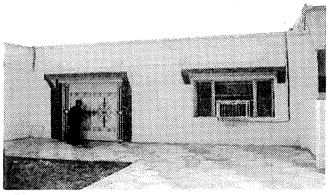


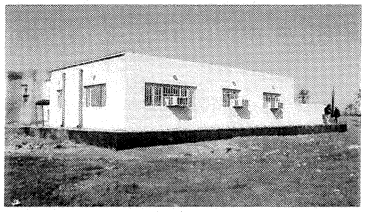
Completed Repair Work At Al Basrah University





Al Bujassim Clinic – Before

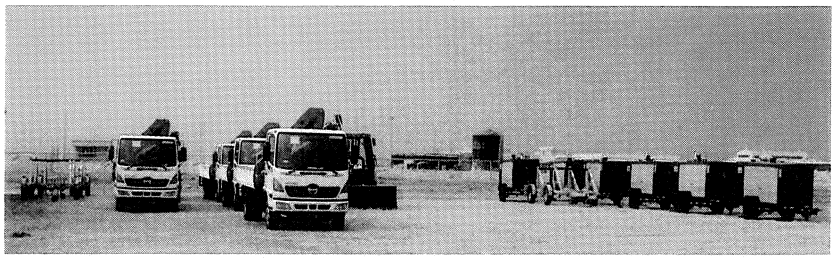




Al Bujassim Clinic – After

Telecommunications

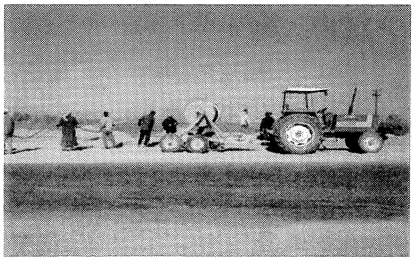
In late July 2003, USAID assigned directed Bechtel to restore 13 telephone exchanges in Baghdad; install an international satellite gateway; and restore Iraq's 2,000 km fiber backbone, which connected key Iraqi cities into a national network. Later, Bechtel was awarded a job order to install another 600 km of fiber optic cable and make further repairs in support of the Iraqi Telephone and Postal Company and the Ministry of Electricity.



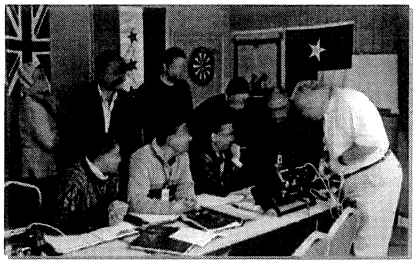
Consolidated Fiber Network Construction Equipment Delivered

Bechtel's work in the telecommunications sector:

- restored subscriber services to over 200,000 telephone users in Baghdad;
- restored country-wide telephone service;
- restored the emergency services network prior to the national elections;
- and provided more than 25,000 hours of training to subcontractors and Ministry staff.



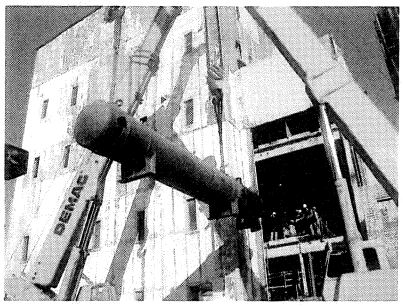
Cable Laying Along Baqubah - Khalis ITPC Backbone



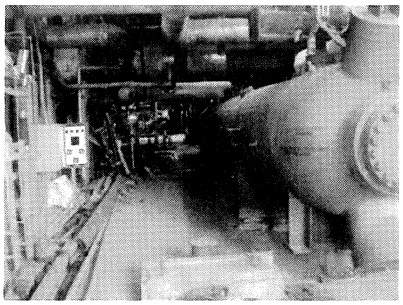
Consolidated Fiber Network ITPC OTDR Training

Power

USAID assigned Bechtel 26 power sector job orders valued at nearly $1.5 billion, or 63 percent of the combined value of Bechtel's Phase I and Phase II contracts. USAID's priority was to get existing generation plants, transmission lines and distribution systems back on line quickly in order to reestablish a sense of order among ordinary Iraqis and re-power the industrial sector, which in turn would stimulate the economy.



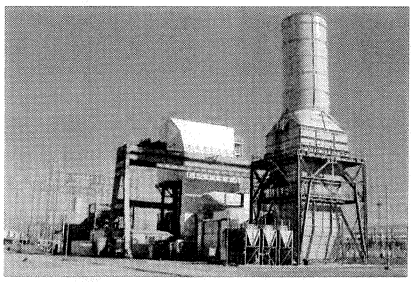
Hartha Heat Exchanger Replacement In Process



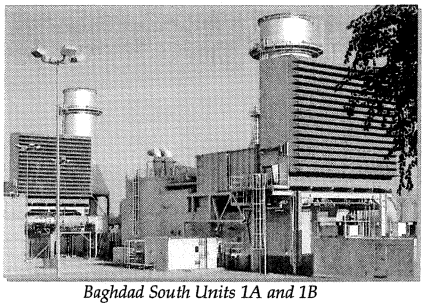
Hartha Heat Exchanger Installation Complete

To this end, Bechtel

- built 4 new power units and rehabilitated 14 existing power units;
- brought on line 540 MW of new generating capacity, 740 MW of rehabilitated capacity; and improved the reliability of 450 MW of existing capacity;
- constructed 160km of high voltage (400kV) transmission lines;
- constructed 25 substations in the Baghdad area and provided equipment for another 12;
- and provided 93,000 hours of operations and maintenance and safety training to Ministry staff.



Completed Kirkuk v94 Power Plant



Baghdad South Units 1A and 1B

Water

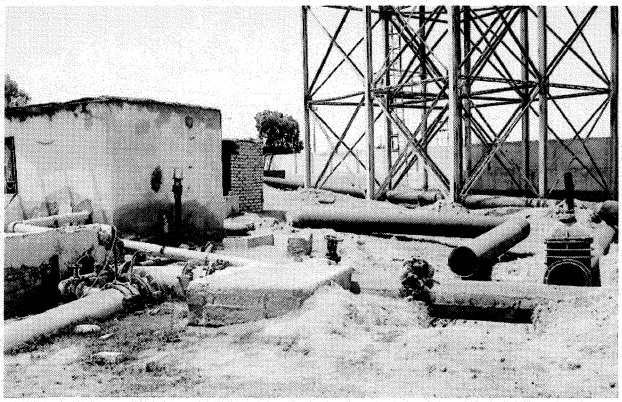
The USAID RFP recognized that water was a critical commodity for the people of Iraq. The primary purpose of the water sector program was to provide safe drinking water and improve sanitation conditions in order to reduce the risk to public health. The original proposal, endorsed by USAID and CPA, was to repair the dilapidated water treatment plants in the south and the wastewater treatment plants in the north and the central part of the country. This would address the upstream root cause of water quality problems and maximize the impact of the restoration effort.

Later, USAID's emphasis shifted to addressing long-term sustainability of the plants, including the provision of consumables, spare parts, and training. Bechtel's 34 water sector job orders had a total value of about $520 million, or 22 percent of the combined value of Bechtel's contracts.

Pursuant to these job orders, Bechtel:

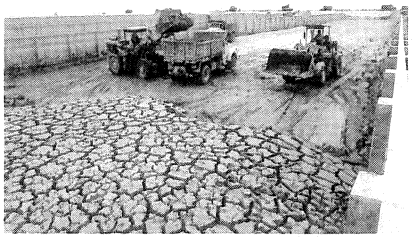
- restored eight and built one new sewage systems (1.2 million m^3/day nameplate capacity);
- restored eight and built one new water treatment plants (2.1 million m^3/day nameplate capacity);
- restored the Sweet Water Canal, tripling its capacity (to 2.1 million m^3/day);
- installed 99 km of new potable water lines and 15,684 household connections in Sadr City; and
- provided more than 325,000 hours of training in operations and maintenance, safety, and business management to Ministry staff.

Additionally, Bechtel completed 70 rural water treatment sites with over 500 distribution points to supply water to over 500,000 rural villagers across Iraq.

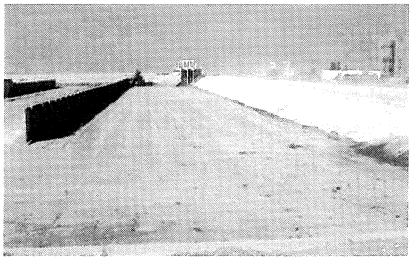


Ruins of the Safwan water plant, since restored by Bechtel

Sweet Water Canal Before

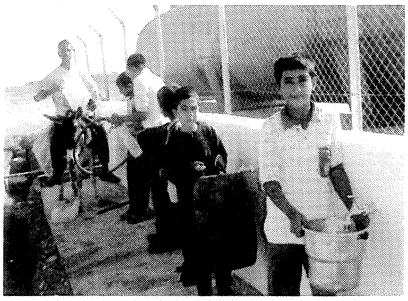


Cleaning The Sweet Water Canal



Sweet Water Canal After

Clean Water In Al Sadr City



Villagers At Diyallah Rural Water Site

Job safety

Bechtel counts safety as one of our core values, wherever we work. We work diligently to maintain one of the best safety records in the industry. In Iraq, we took great pains to insist on world-class safety standards, achieved through the use of proper equipment, training, and safety leadership.

The results speak for themselves. Bechtel's extraordinary effort resulted in historically low lost-time incident rates. The incident rate for Phase II of the Iraq Infrastructure Reconstruction Project (0.04 per 200,000 job hours) was only 1/60 of the U.S. average for heavy construction, an outstanding record by U.S. standards and unheard for Iraq.

Institutional Strengthening

At USAID's direction, Bechtel aimed to leave behind a human legacy in addition to such physical infrastructure as power plants, water treatment facilities, and schools. Through a program dubbed Institutional Strengthening, Bechtel trained staff in Iraq's ministries, agencies, and private subcontractors on modern health, safety, and environmental practices; construction management; plant maintenance and operations; information technology; and ethics. Over the course of Bechtel's two contracts, we performed 636,248 hours of training that will help Iraqis sustain the development and use of their infrastructure.

Working in a conflict zone

Many Bechtel employees worked more than two years in Iraq under extraordinary conditions, demonstrating their commitment to completing the mission. One reason was their confidence in the company to keep them safe and to do what was right. An overarching theme echoed all the way to the top was to "get everyone home safely."

Ensuring the safety of our teams was a major preoccupation of senior project staff, myself included, the entire time we worked in Iraq. It wasn't supposed to be that way. As a civilian contractor, our core competence is building infrastructure, not managing security in a conflict zone. Indeed, our contract specified that we were to work in a "permissive environment"—that is, one without significant life-threatening risks.

From the contract award date until mid-July 2003, Bechtel's assessment teams were able to travel in Iraq either by themselves or with military or private security escorts. Although there were signs of civil unrest, including occasional firefights between Iraqi citizens in the vicinity of the assessment location, employees felt secure enough to continue their work.

In late July 2003, the security situation began to deteriorate. The frequency of attacks against non-military vehicles increased. These attacks consisted primarily of small arms fire and roadside bombs (improvised explosive devices), but included grenades and other weapons dropped from bridges and buildings. On August 10, 2003, USAID issued its first "stop work order" in the Basrah area due to security concerns. The bombings of the Jordanian embassy and United Nations headquarters in Baghdad the same month were devastating indicators of the power of the newly emboldened insurgency. By September, "all international organizations and

contractors, as well as Iraqis cooperating with the CPA, were potential targets of deliberate, direct, and hostile attacks."[6]

By November 2003, the number of attacks against the coalition and its partners was more than double the number in July.[7] In response, Bechtel evacuated more than 50 project employees from Baghdad to Amman, Jordan. Bechtel decided to permanently move non-essential services to the office in Amman in order to reduce overall security risks in Iraq.

Across Iraq, attacks against the coalition and its partners, including contractors, increased another 23 percent from 2004 to 2005.[8] As threats to personal and site security mounted, Bechtel hired more security personnel, upgraded their arms, and purchased more armored vehicles. As travel by road became more dangerous, forward camps were placed on power plant sites and secured with barriers and other means. In late 2005, as security conditions continued to deteriorate, expatriate travel to sites was restricted. Our trained Iraqi professional staff took on an increasing share of on-site supervision.

One fundamental effect of all such measures over this three-year period was to greatly drive up the cost of performing work while making project management much more challenging. This outcome, fully intended by insurgent forces, was not limited to Bechtel. As the U.S. General Accountability Office has noted:

> . . . security costs have diverted a considerable amount of reconstruction resources and have led to canceling or reducing the scope of some reconstruction projects. In January 2006, State reported that direct and indirect security costs represent 16 to 22 percent of the overall cost of major infrastructure projects. In addition, the security environment in Iraq has led to severe restrictions on the movement of civilian staff around the country and reductions of a U.S. presence at reconstruction sites, accounting to U.S. agency officials and civilian contractors.[9]

Despite working under such challenging conditions, Bechtel managed to complete all but two of its 99 task orders from USAID. One of the two remaining projects is a water treatment plant in Al Sadr City, a Baghdad neighborhood notorious for its violent opposition to coalition forces, frequent car bombings, and death-squad killings. Work on the water treatment plant is 88% complete. The project was suspended when the subcontractor and top project supervisors were forced to flee the site to avoid assassination.

The other unfinished project is the Basrah Children's Hospital, whose history is discussed at greater length in an appendix to this testimony. As background, it should be remembered that a U.S. embassy assessment noted that Basrah province suffers "routine [insurgent] activity,

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[6] Report of the Secretary-General pursuant to paragraph 24 of resolution 1483 (2003) and paragraph 12 of resolution 1511 (2003), UN Security Council S/2003/1149, December 5, 2003; quote from General Accountability Office, *Rebuilding Iraq: Resource, Security, Governance, Essential Services, and Oversight Issues*, June 2004 (GAO-04-902R), p. 44.

[7] General Accountability Office, *Rebuilding Iraq: Governance, Security, Reconstruction, and Financing Challenges*, Statement of David M. Walker, Comptroller General of the United States, before the Subcommittee on National Security, Emerging Threats, and International Relations; Committee on Government Reform, House of Representatives, April 25, 2006, p. 15. (Hereafter cited as GAO-06-697T.)

[8] *Ibid.*

[9] *Ibid.*, p. 22.

assassinations and extremism"— hardly a permissive work environment.[10] After suffering deliberate attacks against its offices and staff, the International Committee of the Red Cross closed its public offices in Southern Iraq.[11] Three-quarters of the Iraqi staff at a United Nations office in Basrah reportedly submitted their resignations following threats by an insurgent group.[12] Fearing death, Iraqi workers stopped picking up trash or pumping sewers at the American consulate in Basrah.[13] Citing the rampant violence and alleged corruption of police and rival Shiite militias, the British commander in Basrah said, "It's mafia-type politics down here." In one recent month (May 2006), 85 people were murdered in the city, including nine British soldiers, and Iraq's prime minister declared a state of emergency that remains in effect.[14]

To Bechtel, these reports are more than grim statistics and newspaper headlines. At the pediatric hospital site, our site security manager was murdered; the site manager resigned due to death threats; our senior Bechtel Iraqi engineer resigned after his daughter was kidnapped; 12 employees of the Mechanical-Electrical-Plumbing subcontractor were assassinated in their offices, and 11 employees of the concrete supplier were also murdered. In the face of all this, our team still managed to essentially complete the structural concrete placement. Our hope is that the hospital may someday be finished when security permits.

The reality on the ground

Not all of Bechtel's hard-won accomplishments working with USAID have had the impact you or we would have hoped.

The first reason, noted above and obvious to any serious observer of the reconstruction program, is that Bechtel's scope of work was never great in proportion to the country's tremendous needs. Iraq had fought three wars in two decades, was squeezed for years by tough economic sanctions, and suffered terrible mismanagement by a capricious dictatorship.

Second, Iraq lacked functioning government bureaucracies during significant periods of our work. In the first months after the fall of Saddam, Iraq operated without any functioning ministries. As they struggled to reemerge under the new government, the new ministries vied for authority with other government directorates, parastatal organizations, local authorities, NGOs, and the CPA, hampering coordination and progress on infrastructure projects.

Once projects were complete, the plant operating crews we trained often lacked the leadership, resources, or motivation needed to run and maintain their facilities. Local ministry staff either did not exist or did not attend training sessions to support such facilities, nor did they budget for or purchase essential supplies and spare parts to run them. As the General Accountability Office noted recently, "In the water, sanitation, and electricity sectors, in particular, some projects have been completed but have sustained damage or become inoperable due to Iraq's problems in maintaining or properly operating them."[15]

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[10] *Ibid.*, p. 11.

[11] *Al-Hayat*, July 17, 2005.

[12] *New York Times*, June 4, 2006.

[13] *New York Times*, June 1, 2006.

[14] *New York Times*, June 1 and 13, 2006.

[15] GAO-06-697T, p. 23.

The single most devastating impediment to Iraq's enjoyment of improved infrastructure, however, has been relentless sabotage by armed insurgents and black marketers. Tribal chiefs reportedly pull down transmission lines, sell materials from the downed lines, and then charge authorities for the right to repair them.[16] In turn, power generation stations are stranded when transmission lines are cut or fuel pipelines are blown up. Water treatment plants have been shut down by the accumulation of dead bodies in canals. Key Iraqi operating staff are often forced to abandon their posts or face death.

As the Department of Defense reported to Congress in May 2006, the infrastructure attacks have had

> a disproportionate impact in part because infrastructure repair is hampered by insurgent and criminal intimidation of repair contractors and maintenance workers. In the electrical sector, this has caused significant delays in repair of high-voltage lines. The resultant instability of the high-voltage transmission system has degraded the transmission and generation reliability of the national grid, causing frequent interruptions and blackouts.[17]

Conclusion

Serious people can debate the aims, strategies, and implementation of U.S. policy in Iraq, including the widespread use of private contractors. I come here today not to defend or condemn public policies debated and decided by our elected leaders, but to explain Bechtel's record. We are engineers and builders, not politicians or soldiers. As one of the largest contractors in the United States with worldwide experience, we responded to an urgent request from USAID and won two contracts by competitive bid, with the highest technical scores and lowest price.

We have more than met our obligations to our customer and the American people. As USAID stated in its 2004 publication, *A Year in Iraq*, "Bechtel ended up performing exceptionally well under extremely difficult circumstances." The record will show that we have continued to perform exceptionally well under even more difficult circumstances to the end of our contract this year. We successfully completed all but two of the 99 job orders given us by USAID, despite the immense challenge of operating in an often chaotic and extremely dangerous environment. We have provided the people of Iraq with new power capacity, clean water and sanitation, transportation and communications infrastructure, and refurbished schools. We employed more than 40,000 Iraqis on our projects. We provided training to thousands of Iraqi professionals and craft workers. And we accomplished all this with a safety record that would be the envy of any firm operating in the United States. We are proud of our record in Iraq.

Attached: Appendix

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[16] U.S. General Accountability Office, *Rebuilding Iraq: More Comprehensive National Strategy Needed to Help Achieve U.S. Goals and Overcome Challenges*. Statement of David M. Walker, Comptroller General of the United States, before the Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform, House of Representatives, July 11, 2006, p. 20. (GAO-06-953T)

[17] Department of Defense, *Measuring Stability and Security in Iraq*, May 2006, p. 37. Report to Congress in accordance with the Department of Defense Appropriations Act 2006 (Section 9010).

Appendix

Al Basrah Children's Hospital Historical Record

September 15, 2006

Executive Summary

Bechtel National, Inc.'s (BNI's) Phase II Iraq Reconstruction team has been working on the Al Basrah Children's Hospital (BCH) in Iraq since 2004.

Originally envisioned as a state-of-the-art pediatric and teaching hospital, the BCH was to be a joint initiative of the U.S. Agency for International Development (USAID) and Project HOPE, a non-governmental organization that assumed responsibility for supplying medical equipment and training the hospital staff.

BCH's scope underwent several major changes based on discussions between USAID and Iraq's Ministry of Health, and USAID eventually settled on a 16,200 square meter, 94-bed facility supporting oncology and pediatrics.

The project faced major challenges, including severe security conditions, region-wide cost increases in labor and local materials, undisclosed soil conditions, protracted disputes among contractors, and an extraordinarily ambitious project timeline.

Congress had budgeted $50 million for the hospital, and BNI informed USAID in May 2005 that the total projected costs for the hospital would exceed that amount. USAID directed that only direct costs should be applied to the $50 million cap. Based on this direction from USAID, the BCH was sized, scoped and a design-build subcontract awarded by BNI. The Iraq Reconstruction Management Office in May 2006 overruled USAID, insisting that the $50 million cap applied to all costs, direct or indirect. Under that interpretation, it was already clear that the cap would be exceeded. USAID therefore instructed BNI to issue a Partial Notice of Suspension to our contractor, MidCon, on June 10, pending consultation with Congress about the funding cap. MidCon and its subcontractors continued to work on authorized activities, then halted all construction on August 31 per BNI's instruction.

As Bechtel's contract in Iraq drew to a close, USAID evaluated several alternatives to complete the BCH as a stand alone project. USAID ultimately decided to transfer management of BCH and one other BNI project (Sadr City Water Treatment Plant) to the U.S. Army Corps of Engineers (USACE).

Bechtel is ensuring the smooth transition on the Basrah Children's Hospital to USACE and will continue to fully cooperate with USAID should they need our assistance in the future.

Historical Record

Introduction

BNI was selected from a field of six competitors by USAID on April 17, 2003, to support infrastructure reconstruction in Iraq, including work related to power, water, transportation, communications, and buildings. The initial contract (Phase I) had a value of $680 million, which evolved into a final value of $1.03 billion at completion on December 31, 2005. Subsequently, a second contract (Phase II) was awarded January 5, 2004, with a value that evolved from an initial $1.8 billion to a currently estimated $1.28 billion. Both contracts were competitively bid as standard cost-plus fixed fee contracts.

The BCH was not included in either contract initially but became part of the Phase II effort. It was envisioned as a state-of-the-art pediatric and teaching hospital, with a focus on acute care and oncology services.

Defining Scope

The BCH first surfaced as a potential project on February 12, 2004, when USAID requested a "fast cost estimate" for a new 200-bed pediatric hospital. Initially designated "The Iraq National Children's Hospital" (and sometimes also described as the "Laura Bush Children's Hospital"), BCH was to be a joint initiative of USAID and Project HOPE, a non-governmental organization that assumed responsibility for supplying medical equipment and training the hospital staff.

Planning and design of a hospital can take years as the needs and suggestions of many interested groups are addressed. To accelerate the process, BNI began outlining the basic steps for launching the project as soon as USAID expressed interest:

- Negotiate a firm scope for the project (size, number of beds, specialization, and budget)
- Prepare the site as quickly as possible using Iraqi subcontractors
- In parallel, advertise, bid, award and mobilize an international contractor for the design and construction of the hospital building(s).

Over the course of several months the project repeatedly underwent fundamental changes based on discussions between USAID and Iraq's Ministry of Health (MOH):

- Originally estimated at $250 million to support a 200 bed, 45,000 square meter pediatric hospital[18]
- Reduced to a 15,000 square meter, $50 million, 35-50 bed pediatric and teaching hospital
- Enlarged to a 27,000 square meter, 100+ bed facility focusing on oncology
- Reduced to a 16,200 square meter, 94-bed facility supporting oncology and pediatrics

USAID and the MOH settled on the last alternative after BNI presented an in-depth cost analysis in February 2005. The requirement for design of a hospital that could be expanded to the original vision of 200 beds was included in the job order. After final negotiations with the

[18] The $250 million included medical equipment, certification, and other costs. Estimate for design and construction was $93.8 million for comparison purposes.

winning design-build contractor, BNI requested a Job Order Amendment (JOA) to incorporate the changes in scope, cost and schedule. USAID approved the request on July 7, 2005. This marked the official scope definition of the project.

Site Selection and Preparation

Iraq's Ministry of Health provided a 13-acre parcel of land located in the southern perimeter of Al Basrah to USAID for the future hospital. As the property was prone to flooding during the rainy season, significant excavation, backfill, grade elevation and compaction were required to properly prepare the site.

The MOH characterized the site as capable of supporting a three-story hospital building without the need for a pile-supported foundation. When bore samples raised questions about the load-bearing capacity of the site, however, BNI passed the soils analysis to an independent laboratory in Saudi Arabia. On November 3, 2004, the Saudi lab confirmed that the soil would not support the weight of the BCH building. BNI decided to use a pile foundation and immediately advised USAID. This requirement added approximately 90 days to the schedule and $2.5 million to the cost.

Design-Build Contracting

In August 2004, BNI contracted with Summa Engineering, Inc. headquartered in Farmington Hills Michigan, for consulting services in hospital planning, scope development and refinement. As Summa was a registered minority firm, BNI was able to fast-track the subcontract by mid-August, 2004. Summa's principal was a native Iraqi. Other contributing factors to Summa's selection included:

- Substantial hospital planning and development experience
- Experience with pediatric hospitals in the Middle East
- Arabic language fluency, required to interface with Iraq Ministries.
- Ability to develop lists of architectural and engineering firms suitable for the design/build competition, assist in the tender preparation, and help evaluate the submittals.

To select the design-build contractor, an international competition was held in Amman, Jordan, in order to facilitate communications with the international participants. 33 firms expressed interest and BNI solicited detailed information submittals from each candidate firm. Ten teams responded on September 14, 2004. After presentations and interviews, a consortium of Mid Contracting, Universal Hospital Services, and Hospital Design and Planning was selected as the winning team in October. The team members had excellent credentials:

- Mid Contracting, Inc. (MidCon) is one the largest construction companies in Jordan. Headquartered in Amman, MidCon specializes in fast track construction throughout the Middle East and has built some of the largest luxury hotels in Jordan as well as a number of hospitals. MidCon had approximately $50 million in projects underway in Iraq when selected for the BCH project.
- Universal Hospital Services (UHS), also headquartered in Amman, is a large hospital planning and consulting company performing services throughout the Middle East. UHS has expertise in planning, interior design, medical and administrative staff recruiting and training, medical and administrative operations analysis, medical equipment planning, and program management.

- Hospital Design and Planning (Overseas) Ltd. (HDP) is a hospital planning and design firm. Headquartered in the United Kingdom (Jersey), HDP focuses on the Middle East, with major offices in Amman and Abu Dhabi. HDP has a long record of successful hospital projects.

The project timeline required an engineering, procurement, and construction approach outside of the standard design-build or design-bid-build process. An immediate Limited Notice to Proceed agreement using hourly rates was awarded to the MidCon team for development of a conceptual design. Design review was conducted by a steering committee including BNI, USAID, Project HOPE, and the MOH. The conceptual design package was then used by BNI for negotiation of a Lump Sum Turn Key agreement with the MidCon team for detailed design and construction. Detailed design began in October 2004. Schedule demand required construction to start six months later, before the detailed design was complete.

As construction activities began on April 14, 2005, it soon became evident that MidCon was not able to staff the job with the management and supervision necessary for successful project execution. MidCon was unable to place a sufficient number of qualified construction supervisors willing to work on the jobsite due to the security situation. They also struggled to source an adequate number of experienced construction management personnel capable of functioning in the chaotic Iraqi environment. BNI adjusted the staffing plan to provide additional Iraqi and expatriate staff to the construction organization across all disciplines.

Security Issues

The BCH project presented extraordinary security challenges. It was located immediately adjacent to a very poor, densely populated, politically turbulent residential area. The project would involve a significant number of expatriates over a relatively long construction period. It would also involve a large number of local sub-contractors, craft workers, and laborers who could be subject to intimidation and violence for association with a foreign-sponsored project.

When the project was first conceived, Basrah was one of the most peaceful locales in Iraq. As the BCH project took shape, the security situation throughout Iraq grew progressively more difficult. Kidnappings and beheadings of Iraqis and foreign expatriates became frequent occurrences. In Basrah, highly sophisticated roadside bombs appeared throughout the area, including on all routes approaching BCH. Local police became unreliable and sectarian militias effectively ruled the streets. The Iraqi central government's progressive loss of authority in Basrah made it impossible for the Ministry of Health to support the hospital project normally.

By August 2005, Bechtel expatriate personnel were permitted to travel to the work site only for "project critical" purposes, even under protection of armed guards. BNI's Iraqi engineering staff helped to drive construction, supported by digital photos, email, daily telephone calls and web cameras, but the increasing levels of intimidation, kidnappings and murders had a pronounced impact on MidCon's staff and subcontractors. Among the most significant security incidents were:

- The murder of the site security manager
- Threats and intimidation resulting in the resignation of the site manager
- The resignation of our senior Bechtel Iraqi engineer due to the kidnapping of his daughter
- The murder of 12 employees of the subcontractor's Mechanical-Electrical-Plumbing (MEP) sub tier contractor
- The murder of 11 employees of the subcontractor's concrete supplier.

Productivity at the site suffered from public disturbances that caused late starts or early finishes, as well as from prolonged absences or resignations of targeted individuals. This exceptional security environment was a major factor in deteriorating relations between MidCon and their subcontractors.

Cost Escalation

A basic challenge facing the BNI team was to develop realistic cost estimates and a project budget without metrics based on recent construction experience in Iraq. Labor and local materials in Iraq had been very inexpensive in mid-2003, but began escalating rapidly as reconstruction activity increased. Indeed, construction costs across the entire Middle East grew 30 percent in 2004.

In January 2005, when the design was 20 percent complete, BNI asked a specialist subcontractor, Omrania, to perform a full cost estimate based upon the drawings. The first estimate came in at $1436/square meter, versus $1000/square meter in the original estimate. A primary factor was the nationwide escalation in construction costs of 30 percent to 40 percent per year, with Iraqi sub-contractors demanding increased profits due to commercial and security risks. This trend was particularly severe in Al Basrah, where U.S. agencies had funded many new construction projects. Several other key drivers of rising costs included:

- Increased site and personnel security ($4.5 million).
- Additional security escorting trucks ($300 - $500 per truck trip).
- Requirement for piles in the foundation ($2.5 million).
- Requirement for 100 percent backup electrical power ($1 million).
- Requirement to purchase primary electric power transformers normally provided by the municipality ($400,000).
- Foreign exchange rate fluctuations (USD to Iraqi Dinar).

BNI informed USAID of the rising cost projections on February 16, 2005 and proposed that USAID either reduce hospital's footprint to 10,000 square meters or increase the available funding. USAID declined the option of a smaller hospital and asked BNI to scrutinize the design for possible savings. Later that month, BNI presented a range of options for reducing costs as much as $3.7 million. Over the next four weeks, USAID evaluated the options and directed scope modifications that decreased costs by $2.3 million. These modifications were reflected in Job Order Amendment 1 approved on July 7, 2005. At this point, the forecast was $41.1 million in direct costs (costs directly attributable to building the hospital such as subcontracts and materials).

Costs continued to rise due to the impact of worsening violence on worker productivity (lost hours and days) and transportation (armed escorts required for materiel and personnel). The project also suffered a general loss of productivity due to MidCon's ongoing disputes (exacerbated by security issues) with their sub-tier contractors, which resulted in numerous work slowdowns and shutdowns. By early May of 2006, the forecast had risen to $48.9 million in direct costs.

Cost Allocation

The budget for the project was $50 million per the direction of Congress. Early on BNI informed USAID that the total cost for the hospital, including both direct costs (construction) and indirect

costs (camp operations, security, etc.) would exceed the $50 million cap. USAID consistently interpreted the $50 million as including only direct costs.[19]

Also in the May 2006 timeframe, the Iraq Reconstruction Management Office (IRMO) instructed USAID to account for costs according to sub-sectors rather than just for major sectors (power, water, etc.). This changed the basis for calculating overall costs of individual projects. USAID asked BNI to develop methodologies that they could use for this type of accounting. Using these methodologies, projected indirect costs ranged from $27 million to $49 million, and when added to the direct costs of $48 million, brought the total projected project costs to between $75 million and $97 million. IRMO informed USAID that all costs (not just direct costs) be within the $50 million cap.

Based on USAID's direction not to exceed $50M under the revised methodology, Bechtel:

- Informed USAID that sufficient funds were not available and advised that work on BCH be suspended
- Determined the reduced scope of work that could be completed within the $50M limit
- Issued a Notice of Suspension to MidCon in line with USAID's direction.

At this point, Bechtel's contract was drawing to a conclusion and the full burden of fixed indirect costs was being borne by the two remaining Job Orders. Bechtel discussed options to complete the BCH with USAID and they decided to transition the remaining work on the hospital to the USACE. A termination notice was issued to MidCon to stop construction on August 31 and terminate all activities by September 30. MidCon and its subcontractors continued to work on authorized activities, then halted all construction activities per BNI's instruction on August 31. Site security and caretaking will continue until September 30, at which time the USACE will assume control of the project.

Schedule Interpretation

BNI performed an assessment of schedule and cost in early 2006 that yielded a completion date of July 2007 if security conditions did not worsen. The USACE performed a schedule assessment around the same time and reached similar conclusions. These assessments took into consideration progress to-date, historical trends in procurement, delivery and construction, security, and other related factors.

USAID Disclosure and Concurrence

Throughout the project, BNI has maintained complete transparency vis-à-vis USAID. Since the inception of the reconstruction program, BNI met with USAID three times each week to review schedule and cost on the various projects throughout Iraq, including the Al Basrah Children's Hospital. Additionally, BNI provided schedule and cost information concerning the hospital to the Iraq Reconstruction Management Organization in March of 2006 and cooperated fully with the Assessment Team commissioned by USAID.

Conclusion:

As of September 15, 2006, Mid-Con has brought an orderly closure to the construction and procurement activities within their scope. Design engineering is complete. The acquisition of major equipment for the project is nearly complete. Structural concrete placement has reached approximately 89 per cent of the total required. Block work construction is 25 per cent complete.

[19] USAID formally confirmed this interpretation in a letter (CO-BNI II-05-048) to BNI on November 16, 2005.

Additionally, significant amounts of finishing material (electrical cable, appliances, fixtures, etc) are in storage awaiting installation. Outside of Bechtel's scope, Project HOPE has reported significant progress on the acquisition of major medical equipment and training of hospital staff.

The final inspection of the physical work completed was accomplished with USAID on August 31 and BNI plans to transition the Job Order to the US Army Corps of Engineers on September 30. The Bechtel Basrah Camp will be turned over to USACE on October 1.

Chairman TOM DAVIS. Thank you both very much.

I am going to start Mr. Robbins off. I will start with you on the Academy. Your firm had the contract for construction of the Baghdad Police College. Of course, when we asked you here, this wasn't even on the agenda, but the report got, so I have to ask you. It was the subject of today's Special Inspector General's Report.

I understand that much of the work in question was actually performed by a subcontractor, but your firm had the overall responsibility for the project. What is the explanation?

Mr. ROBBINS. Mr. Chairman, in fact we had 13 Iraqi subcontractors working on this complex.

Chairman TOM DAVIS. Well, you saw the report. This isn't the type of work that Parsons has traditionally been associated with. That is fair to say, isn't it?

Mr. ROBBINS. No, it is not. The buildings in question, the cadet barracks, were all completed in the April-May timeframe of 2006. They were inspected and the quality control was done by Parsons, with quality assurance by the Corps, both of whom signed off on the facilities as being completed. The plumbing systems which have caused this problem were pressure-tested according to standard.

Chairman TOM DAVIS. Who tested them?

Mr. ROBBINS. We had independent labs and our own engineers. There is a normal test that you conduct on a pressurized drain system.

Chairman TOM DAVIS. But there is no city inspectors or Federal Government inspectors that come out?

Mr. ROBBINS. Other than the Corps QA person that was there and witnessed the test, along with the Parsons person——

Chairman TOM DAVIS. So the Army Corps was there to witness the test?

Mr. ROBBINS. Yes, they were.

Chairman TOM DAVIS. And basically did they approve who you had testing it and everything else?

Mr. ROBBINS. Yes, they did.

Chairman TOM DAVIS. So the Corps was overseeing this?

Mr. ROBBINS. The test results were published and approved. The buildings were accepted. Again, this was in the late April, early May timeframe. And Parsons was essentially complete then. We turned the buildings over to the government.

Chairman TOM DAVIS. And you got paid?

Mr. ROBBINS. Well, we are still getting paid, but yes, sir. We submitted invoices and that continues as subcontractor invoices come in.

About the first week of July, we were notified by the Corps that there was a problem with the plumbing in these facilities and even though, again, our contract was completed, they asked us if we would send our engineers out to assess the issue, and we did. We dispatched a couple of our engineers from the IZ, the International Zone, to look at it. They discovered this workmanship issue. There was no question. You are right. This is not correct.

We, with the Corps, got the subcontractor who had performed the work to come back.

Chairman TOM DAVIS. Had this subcontractor done previous work for you?

Mr. ROBBINS. This was the only subcontract that he had with us, was for these barracks.

Chairman TOM DAVIS. OK. This was an Iraqi contractor?

Mr. ROBBINS. Yes, it is an Iraqi subcontractor.

Chairman TOM DAVIS. It wasn't Halliburton?

Mr. ROBBINS. Oh, no, sir.

Chairman TOM DAVIS. OK. I just wanted to take that off the table.

Mr. ROBBINS. As I said earlier, all of our subcontracts were with Iraqi firms for construction.

Chairman TOM DAVIS. OK.

Mr. ROBBINS. And we had withheld payment on that sub until some time had passed, and the warranty on the work was in fact passed to the Corps down to the Iraqi Police Academy administration to enforce the warranty. So they called the company, the subcontractor, back in. And as the IG report notes, the Iraqi subcontractor is in fact replacing all of the, it is not substandard plumbing, it is substandard installation. So the entire plumbing network for those barracks is being replaced.

Chairman TOM DAVIS. Now, you heard Mr. Bowen say that they had 13 out of 14 contracts they had looked through, that your work was basically inadequate. At 14, you talked about the termination for convenience, and frankly he didn't go after that contract. He didn't get into that.

Mr. ROBBINS. Right.

Chairman TOM DAVIS. What is going on here? What is your explanation?

Mr. ROBBINS. I was not able to take the notes fast enough on which 13 sites he visited, but I recall he said he visited, for example, 5 border forts, and I think we did 119. I mentioned how remote they were. What he said was that the construction was substandard. Each of those facilities was completed by Parsons' subcontractors. Inspections were conducted by us and by the Corps and the buildings were all accepted as complete and in compliance with the contract in terms of materials and workmanship.

Chairman TOM DAVIS. By the Corps of Engineers?

Mr. ROBBINS. By the Corps. Now, I don't know without seeing exactly what Mr. Bowen is talking about what kind of issues there were on those border forts.

Chairman TOM DAVIS. Right.

Mr. ROBBINS. But I have also heard this morning quite a bit of discussion about expectations from Iraqi subs. I would suspect that it is safe to say the further you get from the large cities, industrial areas, the less likely you are to find any skilled craftsman to do work. And subcontracts, in Iraq I think it is safe to say all contracts is local. You deal with the firms that are there. These were all competitively bid. Tenders were put out on the market in the Iraqi market.

Chairman TOM DAVIS. Was your contract competitively bid as well?

Mr. ROBBINS. Yes, sir.

Chairman TOM DAVIS. OK, so you beat out other companies to be able to do this.

Mr. ROBBINS. That is correct.

Chairman TOM DAVIS. Well, I mean, you saw the pictures. A picture is worth 1,000 words, and I don't need to sit here and walk through it, but this has to be corrected. The fact that they went back and looked at 13 out of 14 projects they inspected were substandard tells us there is a problem. I think the Corps of Engineers will be called up appropriately, but I also think, if you look at that as the contractor in charge of that, that there is a problem here that we are going to have to take a look at obviously. I am sure you are going to have auditors crawling all over as we move this through.

Mr. ROBBINS. Yes, sir.

Chairman TOM DAVIS. Mr. Waxman.

Mr. WAXMAN. I am going to let Mr. Van Hollen go ahead.

Chairman TOM DAVIS. Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. I would like to followup on some of the questions regarding the Police Academy, because as I understand it, you signed off, Parsons signed off on the project. Right?

Mr. ROBBINS. That is correct.

Mr. VAN HOLLEN. It is a simple question. How could you sign off on a project, or how could it be that the tests conducted did not reveal the huge problems we see? I mean, how can any reasonable test designed to determine whether or not this is ready for the purposes it was designed for, not reveal these massive, massive problems?

Mr. ROBBINS. Sir, the tests were conducted. The systems passed the test and were signed off by our inspectors and the Corps. I can't address why the tests, which were conducted according to standard methodology, failed to detect these fittings. I have some conjecture, that is all it would be, and that is, it took a while of use for this to manifest itself, for the fittings to come loose or whatever.

That is purely conjecture, but to me it is the most explainable explanation.

Mr. VAN HOLLEN. How much was Parsons paid for the Police Academy project?

Mr. ROBBINS. Our definitized final agreed-on costs for the entire program was about $72 million.

Mr. VAN HOLLEN. About $72 million?

Mr. ROBBINS. Yes, sir.

Mr. VAN HOLLEN. And how much profit did Parsons make on this project?

Mr. ROBBINS. Sir, all of our Iraq contracts, the two design-build contracts, had a 3 percent base fee and a 12 percent award fee associated with them. The 3 percent base fee applied primarily to labor and some other direct costs. It did not apply to others, such as security, life support.

Mr. VAN HOLLEN. So 3 percent on top of costs, and then 12 percent?

Mr. ROBBINS. And then 12 percent award fee based on the Government's evaluation of our performance.

Mr. VAN HOLLEN. So what was the amount of that award fee, the 12 percent?

Mr. ROBBINS. Well, there are different periods, so the first period covered part of when we were doing the design. What I will tell you, on the period in question, our award fee was zero.

Mr. VAN HOLLEN. What was the cumulative award fee?

Mr. ROBBINS. Sir, I really don't know.

Mr. VAN HOLLEN. Can you get that for the record? Look, I mean, that is a question here. The question I think the American people would be asking, my constituents would be asking is how is it that a job that clearly turned into this kind of disaster, how is it that the Federal Government would actually pay the money? Is this something that you are going to go in, and are you going to return the money? What is the recourse for the taxpayer in these circumstances? Don't you think that Parsons, given what has turned out to be a very shoddy job, should return some of its profits to the taxpayer?

Mr. ROBBINS. Sir, I will merely say that Parsons will abide by the terms of the contract and we will deal with the Government on a fair basis, and we will abide by whatever the decision is.

Mr. VAN HOLLEN. So you won't voluntarily look at this and say, given what has happened in this project, we will return the profit.

Mr. ROBBINS. No, sir, I will not.

Mr. VAN HOLLEN. Do you think this was a job well done?

Mr. ROBBINS. I think parts of it and a lot of it was well done, yes, sir.

Mr. VAN HOLLEN. Do you think the taxpayer got a good return on its investment for this project?

Mr. ROBBINS. I think the taxpayers got what our contract called for it to get.

Mr. VAN HOLLEN. I am sorry, but you think that this is what the contract called for?

Mr. ROBBINS. No, sir. And that is why we are repairing it at no cost to the Government. It is being repaired at no cost to the Government. We have warranties on construction. There are no construction bonds in Iraq. And so the situation is being remedied.

Mr. VAN HOLLEN. The cost-plus feature of these contracts provides no incentive to the contractor to keep down costs. Is that right?

Mr. ROBBINS. No, sir. It provides every incentive, I believe, to the contractor to keep costs down.

Mr. VAN HOLLEN. I thought I understood your testimony to be you got paid 3 percent on top of costs.

Mr. ROBBINS. Yes, sir. I would suggest that 3 percent is not particularly a very good return on investment. In fact, the reason for the award fee is to in fact incentivize you to do your best and to be recognized for doing that. The Government determines the amount of that award fee.

Mr. VAN HOLLEN. OK. Just sticking to the cost-plus, I mean, 3 percent of a bigger number is going to be a bigger number, right?

Mr. ROBBINS. That is correct.

Mr. VAN HOLLEN. So I mean, there is no incentive in that system to keep to costs.

Mr. ROBBINS. Well, actually there is because of the definitized costs. You are paid your base fee based on a definitized cost. Any growth after that, there is no fee paid.

Mr. VAN HOLLEN. OK. I will just close. So what were the criteria that the U.S. Government used to determine that you got the 12 percent award fee?

Mr. ROBBINS. Sir, it changed about four times over the course of the last 2 years, but it was everything from how well we did the capacity-building aspects of it. There are safety features. There are quality issues. There are schedule metrics. There is a whole litany of measurement that the Government uses to determine the award fee.

Mr. VAN HOLLEN. OK.

Chairman TOM DAVIS. Mr. Waxman.

Mr. WAXMAN. Thank you, Mr. Chairman.

In August 2004, Bechtel was tasked with building a state-of-the-art children's hospital in Basrah. The hospital was supposed to be finished by the end of 2005 at a cost of $50 million. By March 2006, however, the expected completion date had slipped by 19 months and the expected cost had grown to $98 million. As a result of the schedule delays and cost overruns, USAID took Bechtel off the project in June, and the Army Corps of Engineers contracted directly with Bechtel's Jordanian subcontractor, MidCon, in September. I have a copy of the Corps of Engineers' justification and approval document. Mr. Chairman, I would like to place this document in the record.

[The information referred to follows:]

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY
ACQUISITION LOGISTICS AND TECHNOLOGY
103 ARMY PENTAGON
WASHINGTON DC 20310-0103

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GOVERNMENT REFORM
COMMITTEE

The Honorable Tom Davis
Chairman
Committee on Government Reform
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The purpose of this letter is to inform the Committee that the U.S. Army intends to award a $34.4 million contract to Mid-Contracting (MIDCON) using other than full and open competition for the construction of the Basra Children's Hospital (BCH), Basra, Iraq. Funding for the construction of the BCH will come from the Iraq Relief and Reconstruction Fund (IRRF) of the Emergency Supplemental Appropriations Act for Defense and the Reconstruction of Iraq and Afghanistan, 2004 (Public Law 108-106). You were notified by the Department of State on July 26, 2006, of the reapportionment of these funds for this purpose. However, in compliance with Section 2202(b) of Public Law 108-106, the Chairman and Ranking Members of the Senate Foreign Relations Committee, the Senate Homeland Security and Governmental Affairs Committee, the House International Relations Committee, the House Government Reform Committee, and the House and Senate Appropriations Committees must also be notified seven calendar days prior to the non-competitive award of an IRRF-funded contract valued at or over $5 million.

The U.S. Army's intent to award this contract to MIDCON is occasioned by the U.S. Agency for International Development's decision to stop work on the BCH construction project under its 2004 contract with Bechtel National, Inc. (BNI). MIDCON was BNI's construction subcontractor on the BCH project. The U.S. Government currently has a $50 million investment in the project, which is 30 percent complete and MIDCON has remained at the construction site to secure the partially completed work and is employing workers from the local Basra area for that purpose.

The justification for use of other than full and open competitive procedures is based on the substantial duplication of cost to the U.S. Government that is not expected to be recovered through competition, and the adverse effect caused by further delay in fulfilling the agency's requirements. The scope of the contract calls for the construction of a 160,000 square foot facility (without equipment) consisting of a building to support a 94-bed acute and referral care center, two utility buildings, a building to support a 36-bed residence, and parking lot. The amount of the contract is expected to be $34.4 million. Because of MIDCON's prior experience with the BCH project and its ability to quickly mobilize and resume construction operations without a substantial duplication of cost, the U.S.

Army has determined that it is in its best interests to continue with MIDCON as the follow-on construction contractor for the BCH. As such, MIDCON is the only contractor identified by the agency and the only contractor from whom an offer will be solicited. The list of contractors solicited is limited to MIDCON. The justification and approval document upon which provides the basis for other than full and open competitive procedures is enclosed.

We appreciate your continued support of the U.S. operations in Iraq. We are available to provide any additional information you or your staff may require.

Sincerely,

Claude M. Bolton, Jr.
Assistant Secretary of the Army
(Acquisition, Logistics and Technology)

Enclosure

Copy Furnished:
The Honorable Henry Waxman
Ranking Member

HEADQUARTERS
JOINT CONTRACTING COMMAND-IRAQ/AFGHANISTAN
APO AE 09316

Control Number: 06-45

Justification and Approval for Other than Full and Open Competition

Program/Equipment: Construction of the Basra Children's Hospital, Basra, Iraq

Authority: 10 U.S.C. 2304(c)(1), and FAR 6.302-1, Only one responsible source and no other supplies or services will satisfy agency requirements.

Amount: Iraq Relief & Reconstruction Funds (IRRF) - $34,400,000

Prepared by:
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Contracting Officer:
Name: CDR Julie Hammond, USN
CML: 703-544-1444
Date Reviewed: 29 Aug 06
E-mail: Douglas.collins@pco-iraq.net

Technical Representative:
Name, Lt Col Michael A. Mendoza, USAF
CML: 703-544-6813
Title: Deputy Sector Lead, Project & Contracting Office, Facilities & Transportation
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Requirements Representative:
Name: Colonel Andrew Q. Knapp, USAF
CML: 703-544-6951
Title: Director, Project & Contracting Office, Facilities & Transportation Sector
Date Reviewed: 29 Aug 06

Reviews: I have reviewed this justification and find it acceptable to support other than full and open competition.

Program Manager
Name: Colonel Andrew Q. Knapp, USAF
Title: Director, Project & Contracting Office, Facilities & Transportation Sector
Signature: Andrew Q. Knapp Date: 29 Aug 06

Legal Counsel
Name: Robert A. Hensen
CML: 540-542-1408
Signature: Concur in the result Robert A. Hensen Date: 29 August 2006

Principal Assistant Responsible for Contracting
Name: Douglas W. Packard
CML: 703-544-6390
Signature: Packard Date: 29 Aug 06

Head of Contracting Activity
Name: Darryl A. Scott, Maj Gen, USAF
CML: 703-544-1508
Signature: Date: 10 Sep 2006

Justification and Approval for Other than Full and Open Competition

1. **Contracting Activity**: U.S. Army, Joint Contracting Command-Iraq/Afghanistan
Principal Assistant Responsible for Contracting-Reconstruction
GRD/PCO2-JC
APO AE 09348

2. **Description of Action.** A new firm fixed price construction contract using other than full and open competition will be negotiated and awarded to Mid Contacting (MIDCON) as one of two contracts proposed to complete the construction and equipping of the Basra Children's Hospital (BCH) in Iraq. Iraqi Relief and Reconstruction Funds (IRRF) will be used for the MIDCON contract.

The second contract, which will be for equipment integration, is currently planned at this time, but is subject to receipt of funds. It is expected that this contract will be funded partially with donor nation funds from Spain and Japan; however, these funds have not yet been received by the Department of State. In addition, funds will be provided through the Economic Support Fund in the Department of State and funds from the Iraqi Ministry of Health. This equipment integration contract will also be awarded using other than full and open competition and will be the subject of another Justification and Approval document should the funding required for the contract be made available for award to the Department of the Army.

3. **Description of Project:** When completed and equipped, the BCH facility in southern Iraq will be a "state-of-the-art," 160,000 square foot, 94-bed acute and referral care center with a focus on pediatric oncology. Built on 13-acres, it will be a leader in children's health care for the southern governorates, providing high impact specialty services not otherwise available in Iraq. It will also serve as a "Center of Excellence" with the goal of becoming an educational facility to improve and expand the training of health professionals throughout Iraq, and to become the health facility and best practices model for future hospital renovations and new health facility construction across the country. The total project cost, including construction, equipment, and training of hospital staff, is estimated at $81 million dollars. This Justification and Approval (J&A), however, covers only the award of a sole-source contract for the construction portion of the project at a not-to-exceed cost of $34.4 million.

The project was originally part of the U.S. Agency for International Development (USAID) mission in Iraq. USAID competitively awarded contract SPU-C-00-04-00001 to Bechtel National Inc. (BNI) in August 2004 under FAR Part 15. Job Order 04-511 under that contract is for construction of the Basra Children's Hospital. BNI awarded a design-build construction subcontract to Mid Contracting (MIDCON) in the amount of $37.4M for construction of the hospital. MIDCON subcontracted to Universal Hospital Services (UHS) for equipment integration and to Hospital Designers and Partners (HDP) for the design. The original job order was not to exceed $50M, with an estimated completion date of 31 December 2005. Construction commenced in January 2005. Due to various factors, including the near exhaustion of funds on the job order and BNI's failure to pay MIDCON, by direction of the U.S. Ambassador to Iraq and the Director, Iraq Reconstruction and Management Office (IRMO), USAID agreed not to extend the current job order with BNI. Pending expiration of the job order, USAID issued a stop-work order to BNI in early June 2006. USAID will not extend the BNI contract past the 31 Oct expiration. After notification by USAID, BNI terminated their subcontract with MIDCON on 3 August 2006 to reduce further expenditure of funds during BNI's de-mobilization from Iraq. The U.S. Government currently has an investment in the project of

approximately $50M. MIDCON has remained on site, however, in an effort to secure the project site and continues to employ workers from the local Basra area. The hospital is currently 30% complete

4. Description of Supplies / Services Covered by this J&A. MIDCON will be responsible for all management, construction and engineering services necessary to take the work from its current stage of approximately 30% completion to the completion of the hospital as it was designed. The estimated value for construction completion is $34.4 million.

5. Authority Cited. 10 U.S.C. 2304(c)(1) and FAR 6.302-1, Only one responsible source and no other supplies or services will satisfy agency requirements. Paragraph (a)(iii). It is likely that award to any other source would result in substantial duplication of cost to the Government that is not expected to be recovered through competition, or unacceptable delays in fulfilling the agency's requirements. When using only one responsible source as authority for use of other than full and open competition, full synopsis and publication must be completed unless a local source is being used. MIDCON, which is a Jordanian company, is considered a local source for the following reasons: Jordan is within the Area of Responsibility for the U.S. Government's mission in Iraq and is a Coalition Partner; MIDCON is overwhelmingly composed of local Iraqi employees; MIDCON is considered a local source by the Iraqi Director General, Basra Governorate and the Iraqi Ministry of Health; there are no Iraqi firms capable of performing services under the contract nor would any other firm be accepted by the local community. Therefore, no synopsis and publication is required.

6. Reason for Authority Cited.

As stated Section 3 above, MIDCON has been the primary subcontractor for BNI performing the majority of the work at the Basra Children's Hospital project site. The design is 100% complete and the construction is approximately 30% complete. The completed work will consist of the main 94-bed hospital, two utility buildings, and a 36-bed residence building. The award of a new construction contract to MIDCON will result in completion of the hospital as it was awarded, designed and begun under the BNI prime contract with USAID.

This is a very large and complex medical facility project involving specialized construction that must allow for the installation of multiple health systems that require detailed integration of sensitive, "hi-tech" and architecturally significant medical equipment with the systems and building necessary to support it. The construction contractors must have medical construction experience in order to successfully complete the project. This requirement narrows the pool of available contractors. There are other construction contractors in the world who have this capability. However, to introduce another contractor at this stage of the project will cause delays and increase the costs to the project

In fact, it is unlikely that any cost saving will result from de-mobilizing MIDCON and mobilizing a new contractor to Basra and would be the more expensive approach. According to USAID, settlement costs for MIDCON to de-mobilize are estimated at $4M. Mobilization costs for the new contractor to move onto the job site, set up and begin a construction project of this size are estimated at $3M. MIDCON is currently on site and providing security. Loss of materials at the site would be certain unless security or a military force is stationed there. The cost to contract for a security force to protect the site is estimated at $650K/month. Additionally, taxing a military unit to secure the site burdens already limited deployed forces. In addition, materials and equipment already purchased and on site will need to be transported and stored at another location. Estimated cost is $9 million. Materials valued at approximately $2 million

are already at the site and additional materials are in the pipeline. Any potential cost savings from a full and open competition to complete the project would be offset by the costs that will be incurred if there is an interruption in the construction and the site is closed.

The project was originally scheduled for completion in December 2005. In June 2006, the US Government began an assessment/cost evaluation to determine cost to complete. At the time of the assessment, the project was 273 days behind schedule; reasons include site preparation and pile installation, second and third tier subcontractor labor disputes, the failure of BNI to perform contractually mandated oversight, and MIDCON's performance. MIDCON's performance has suffered due to the failure of BNI to make progress payments to MIDCON in a timely manner. There are a number of large items of equipment and materials that have been purchased and received on the site by MIDCON for which payment has not been received from BNI. This has placed financial burdens on MIDCON. MIDCON has been unable to make progress as it would have if BNI had provided project oversight and progress / equipment payments on schedule. Cash flow is critical to construction contractors as is oversight by the prime contractor, in this instance BNI. As justification, BNI employees state that they were unable to visit the project from October 2005 to March 2006.

The project is on a very tight time schedule due to the delays stated above. It must be completed as promised, not only to meet the critical health needs of both the local community and Iraq for adequate pediatric cancer care, but also to demonstrate to the Iraqi people that progress is being made at an acceptable rate. In particular, the Basra community itself has embraced the project thereby easing ethnic and anti-American sentiments and giving support to democracy. Demonstrating progress is also crucial in order to support and give credibility to the fledgling national government. Completion of this project also supports the Combatant Commander's "Stability Operations" strategy, which looks to locally supported reconstruction projects as critical to the peace.

If a full and open competition is to be conducted, the time required to assess the gaps and current stage of completion; determine what materials are on the site; develop specifications; and advertise / award new construction contract will take a minimum of 120 days. That is a very ambitious timeline and funding would be lost as IRRF funds expire as of 30 September 2006.

As stated above, this is a partially constructed facility which makes developing plans and specifications for a full and open competition very difficult. Normally this situation only occurs when there has been a termination for default; construction has come to a halt; the site has been shut down; and there is time in a secure environment to develop specifications for remaining work. In fact, the normal procedure in construction is that the surety (bonding company) would normally retain a primary subcontractor to complete the work in situations in which the prime contractor is terminated or cannot continue. Unfortunately in this environment, the U.S. Government does not have a bonding company to step in and assume the role of the prime contractor. The U.S. Government does not have a contractual relationship with BNI's subcontractor, MIDCON; therefore the only practicable solution is for the U.S. Government to enter into a sole source contract relationship with MIDCON to complete the hospital. When a construction contract is terminated, the Government is placed in a precarious situation. There is significant danger of loss of the investment. It is difficult to assess the stage of completion and re-advertise the project, and it is just as difficult for a new contractor to mobilize and begin in a partially completed construction site. This is multiplied in the environment of Iraq.

A new contractor is also likely to build a substantial contingency into its offer due to having to assume the financial responsibility to complete a construction project begun by another contractor. Construction and engineering decisions have been made in the early stages of construction that will impact the remainder of the project. This also presents a financial risk to the Government for future changes and differing site conditions to be encountered. The current construction contractor has knowledge of the design and the working relationship with the integration / design partners because they have developed the design together. A new construction contractor will be learning as he progresses. One of the least desirable situations in the construction industry is to change construction contractors and/or construction or design team members after construction has begun. History has proven for both Government and private industry that the most desirable course of action is to complete the construction contract with the current contractor absent a compelling reason to terminate. This is in terms of both schedule and cost. The only available and practicable avenue for the U.S. Government to complete the project for a reasonable price and with the least slip in schedule is to enter into a contract with MIDCON.

Using MIDCON to continue the construction will also ensure that the current U.S. Government investment of $50M will not be lost and will mitigate the cost to complete construction, set up and commission the hospital. In the process of accessing the ability of MIDCON to complete the project, the U.S. Government reviewed work done by MIDCON for other customers in the Middle East and visited one of the company's current construction projects. All have been completed within very tight time schedules. MIDCON is a well known and respected construction contractor who takes on very complex construction projects and has completed them successfully. It is estimated that MDCON will be able to complete the construction within 15 months of award.

As a practical matter, it is not possible to demobilize MIDCON, conduct a competition, and mobilize another contractor, without a substantial gap in both security and construction progress. Even if MIDCON competes and is successful, there will still be a substantial slip in schedule and additional costs incurred for MIDCON's de-mobilization and re-mobilization, movement and storage of materials, and site security during the period the construction is closed down. MIDCON must de-mobilize by 30 September under their current subcontract with BNI. It is physically impossible to prepare specifications, solicit, award and mobilize a new construction contract by 30 September. Any gap in security will result in looting and/or damage to the project. Any contractor other than MIDCON will face a substantial learning curve to adapt to the existing conditions and "pick up" where MIDCON "left off." The delay will not only jeopardize the health needs of the local community, but will also jeopardize the fragile political objectives the completion of this project is designed to achieve.

In order to ensure that the project does not fall victim to additional delays and to ensure the successful completion of the project by MIDCON, the program and project management role previously held by BNI will be transferred to the U.S. Army Corps of Engineers, Gulf Region Division (GRD), due to their experience in managing construction projects of such a complex nature. GRD will establish an on-site Special Project Office to provide the schedule and management oversight that is required for a construction project of this magnitude. This will provide for regular contact with and support for MIDCON, and will ensure payments to the contractor on a regular and timely basis thereby eliminating the company's financial risk factor. The U.S. Government can also ensure limited schedule delays by being on site to work directly with the contractor as a member of the team.

The U.S. Government also proposes to utilize the "Alpha Contracting" technique to form a contract with MIDCON. Typically, acquisition is a sequential process of developing the statement of work, preparing a solicitation, receipt of proposal, evaluation of proposals, negotiation and contract award. Using the "Alpha" process, the statement of work, contract formation and price are developed in parallel as a collaborative effort by a team consisting of the proposed contractor, the contracting officer, the technical staff/engineers, the Defense Contract Audit Agency and legal. In fact, this is the typical scenario of what would occur after termination of a construction contract. Alpha Contracting is an acceptable process that has been used successfully for weapons systems over the past 10 years.

This critical construction project must move forward or the work to date is very likely to be attacked, damaged and destroyed. Under the current political and security situation in Iraq, the U.S. Government can ill afford to place a military force at the site to protect its interests. The site is not hardened and adjoins several Shia neighborhoods. It took time and effort in community relations with the local population so that they could believe and accept that the project was, in fact, a hospital for children and not a prison. MIDCON, with its primary employment from the community, was instrumental in this effort. Any sudden deviation of normal operations or termination of local employees could negatively affect perceptions by the local populace and hinder future progress. U.S. Government strategic interests, theater operational interests and the tactical level interests within Baghdad require the success of the new Government of Iraq and Iraq's essential ministries. It is vital to support the new Government of Iraq and avoid any actions that could lead to negative perceptions of the abilities of the new Government of Iraq or the relationship between the two Governments.

Acceptance by Local Community.

MIDCON is an Arab (Jordanian) firm, accepted by the community and local leaders. MIDCON's physical presence and on-the-job experience working on this facility are primary factors in the decision to solicit only MIDCON and award the contract to complete the project on a sole-source basis. The location in Basra is not unlike Sadr City in Baghdad and brings its own issues of tribal and sectarian violence. Experience in both cities has demonstrated that local communities are distrustful of any contractor who does not have an existing relationship with that community. Where contractors attempt to conduct operations in communities where they have not established such a relationship, violence and disruptions ensue. Often workmen are threatened, or simply kidnapped and killed. Projects are often looted, damaged or even destroyed. In the present environment, only a contractor enjoying a firm relationship and standing in the local community has a reasonable chance of successfully completing this project. In recent discussions with the Iraqi Director General, Basra Governorate and his staff, and Ministry of Health officials in Basra, all clearly expressed that a working relationship had been developed with MIDCON and support continuation of MIDCON's effort to complete construction. This relationship and the fact that MIDCON is a Middle East contractor, as stated earlier, brings a high probability of fewer security problems and successful project completion.

Building Trust with the New Iraqi Government.

The Ministry of Health has expressed a strong desire to complete the project and provided its support at both the national and local governorate levels. Failure to complete this project will be prejudicial to United States objectives and further bolster the insurgency efforts to destabilize the country. Any attempt to replace MIDCON increases the risks in completing the project and would be perceived by the Iraqi Government and the people of Iraq as a lack of the U.S. Government's commitment for the construction of this "Center of Excellence". This may

further destabilize the already fragile political relationship that the new Government of Iraq is attempting to forge with the local population. This is an important symbol to demonstrate the Iraqi Ministry of Health's ability to establish a modern health care system, sustain political support for the counter-insurgency efforts, and bolster Iraqi self-reliance, thereby demonstrating America's commitment to the new government and the people of Iraq.

In summary, MIDCON is currently at the site, has been working at the site and is familiar with the conditions on-the-ground in Basra. MIDCON has demonstrated experience and success in building, equipping and designing hospitals and other projects of this size and larger. MIDCON has become experienced in operating in this hostile environment and built a strong relationship in the Shia neighborhood where the hospital is located. MIDCON was the partner with the designer in developing the hospital. Soliciting and negotiating a contract with MIDCON as the only responsible source to continue construction of the Basra Children's Hospital is the most feasible approach to mitigate cost, complete the project and support U.S. Government objectives in Iraq.

7. Efforts to Obtain Competition.

There were no efforts to obtain competition to complete the construction for the reasons described above. As the market conditions have improved in Iraq, firm fixed price construction contracts have been issued to a more competitive group of local and regional companies to improve costs and to increase local employment. However, there is no benefit in attempting to compete the completion of the Basra Children's Hospital within Iraq. A competition of the new contract is not practicable due to an accelerated schedule to continue current construction, deliver this facility within the additional budget, and focus on saving the initial $50M investment. In addition, the government cannot risk the negative impact that an extended gap would cause during the demobilization of MIDCON start-up and learning curve for a new contractor, and loss of efficiency due to multiple changes in the lower tier subcontracts.

8. Actions Taken to Increase Competition.

No further action will be taken to increase the competition for this requirement. The U.S. Government has determined that it is impracticable for the reasons stated in this justification to conduct a full and open competition to complete the construction.

9. Market Research.

The Joint Contracting Command – Iraq/Afghanistan (JCC-I/A) and the GRD have over two years of international experience awarding, managing, designing and supervising construction contracts including those that provide temporary construction incidental to the performance of services. The services, design and construction market forces are well known by JCC-I/A and GRD. The firms, suppliers, and labor forces available and the requirements necessary for successful completion of the hospital have been thoroughly examined.

The original subcontract for the contract was competed by BNI as required under their cost reimbursement contract with USAID. Various offers were considered by BNI during the early planning period and a final source selection was conducted. BNI opened that solicitation for their prime subcontracting team to the available world market for hospital construction and MIDCON was selected

The U.S. Government also considered a "fast" competition, conducted under 10 U.S.C. 2304(c)(2). A letter contract was contemplated with terms and conditions to be definitized by supplemental agreement to a firm fixed price contract within 180 days after contract award. However, by using the "alpha" contracting process described previously, it is possible to award a firm fixed price contract at the beginning. Awarding a contract without a firm agreement on statement of work, terms, conditions and price carries more risk than negotiating a firm fixed price at the outset.

Based on market research, several firms could perform a large construction project of this type. However, as discussed above, acceptance by the local community is a significant consideration for successful project completion. In addition, as already stated this project is a very large and highly complex medical facility construction project involving specialized construction across multiple health systems and requires a detailed knowledge of the requirements necessary for successful installation of sensitive "hi-tech" architecturally significant equipment. The design is 100% complete and construction is 30% complete. The contractor must have this experience in order to successfully complete a project of this nature, therefore, narrowing the pool of available contractors. Other contractors could compete, but the risks and potential additional costs associated with a new competition are unacceptable to the interests of the U.S. Government in Iraq.

MIDCON was originally awarded the subcontract on a competitive bid after it demonstrated experience in this type of hospital construction. The company is currently constructing a 200-bed hospital facility in Amman, Jordan. It is the only contractor in this region that already possesses full knowledge of the construction status, design, and government property associated with the project. Other local construction firms have recent hospital renovation experience, but there has not been a new hospital constructed in Iraq since 1980.

10. Interested Sources. Based upon the information provided above, only MIDCON, the current subcontractor, will be solicited.

11. Other Facts.

Current Situation: Since 1990, there has been a disastrous decline in people's health with child and maternal mortality rates doubling and adult mortality increasing. There has been little or no observable investment in healthcare for children in health systems facilities; operations and maintenance, or modern training for healthcare providers over the past 28 years. Iraq's ability to provide adequate medical care for it's most seriously ill and injured children is virtually nonexistent.

The cancer registry reports an increase in the number and proportion of cases of leukemia in the southern governorates since 1993. At present, a mere 8% of children stricken with leukemia survive and yet in the United States, 80% survive. Many medical professionals in the country deal with cancer treatment, but there are no full-time surgical oncologists in Iraq. There are no functioning linear accelerators in Iraq and radiotherapy facilities, which exist in only two northern Iraqi cities, are outdated and inadequate. Therefore, there is a pressing need to train full-time oncology specialists, needle cytology, oncologist nurses, palliative nurses, radiotherapy assistants, radiation physicists, dosimetrists and engineers for future linear accelerator services. The Basra Children's Hospital will provide the facilities necessary for training and critical oncology care in Iraq

Due to this lack of adequate pediatric health care, in July 2003, Project HOPE (Health Opportunities for People Everywhere) was invited with the U. S. Government to participate in a public-private partnership to establish a "state of the art" pediatric hospital in Basra. The Iraqi Ministry of Health was a key stakeholder in the scope and function of this partnership. Project HOPE, a non-governmental organization, and as part of its alliance with USAID and the Ministry of Health, has accepted the responsibility for providing major medical items of equipment once the construction of the BCH is complete and is ensuring the training of the staff to allow a modern functioning hospital to serve the needs of the children of Basra.

a. *Procurement History:*

The project was originally part of the U.S. Agency for International Development (USAID) mission in Iraq. USAID competitively awarded contract SPU-C-00-04-00001 to Bechtel National Inc. (BNI) in August 2004 under FAR Part 15. Job Order 04-511 under that contract is for construction of the Basra Children's Hospital. BNI awarded a design-build construction subcontract to Mid Contracting (MIDCON) in the amount of $37.4M for construction of the hospital. MIDCON subcontracted to Universal Hospital Management Services (UHS) for equipment integration and to Hospital Designers and Partners (HDP) for the design. The original job order was not to exceed $50M, with an estimated completion date of 31 December 2005. Construction commenced in January 2005. Due to various factors, including the exhaustion of all funds on the job order, BNI abandoned the project and failed to pay MIDCON. By direction of the U.S. Ambassador to Iraq and the Director, Iraq Reconstruction and Management Office (IRMO), USAID agreed not to extend the current job order with BNI. Pending expiration of the job order, USAID issued a stop-work order to BNI in early June 2006. USAID will not extend the BNI contract past the 31 Oct expiration. After notification by USAID, BNI terminated their subcontract with MIDCON on 3 August 2006 to reduce further expenditure of funds during BNI's de-mobilization from Iraq. The U.S. Government currently has an investment in the project of approximately $50M. MIDCON has remained on site, however, in an effort to secure the project site and continues to employ workers from the local Basra area. The hospital is currently 30% complete.

b. Acquisition *Data Available:*

Technical data packages, as-built drawings, punch lists, engineering design-build drawings, warranties and statements of work are being developed from the current BNI job order. An Alpha Contracting process will be used further refine the statement of work and associated technical documents.

c. Subcontracting *competition:*

The Government contemplates the resultant contracts will provide significant opportunities for subcontracting to Iraqi firms, principally for construction labor. This directly supports the MNF-I Campaign Plan's Economic Line of Operation and will foster capacity development. The contract will include all applicable FAR clauses related to subcontracting, to include flow-down of FAR and DFARS clauses.

13. Technical Certification:

I certify that the supporting data under my cognizance which are included in the justification are accurate and complete to the best of knowledge and belief.

Typed Name: Lt Col Michael A. Mendoza
Date: 29 Aug 06

Signature:
Title: Deputy Sector Lead, PCO F&T

14. Requirements Certification:

I certify that the supporting data under my cognizance which are included in the justification are accurate and complete to the best of knowledge and belief:

Typed Name: Colonel Andrew Q. Knapp
Date: 29 Aug 06

Signature:
Title: Director, PCO F&T Sector

15. Fair and Reasonable Cost Determination:

I hereby determine that the anticipated cost for these contract actions will be fair and reasonable, based on an Independent Government Estimate (IGE):

Typed Name: Lt Col Michael A. Mendoza
Date: 29 Aug 06

Signature:
Title: Deputy Sector Lead, PCO – F&T

16. Contracting Officer Certification:

I certify that this justification is accurate and complete to the best of my knowledge and belief.

Typed Name: Julie Hammond
Date: 29 Aug 06

Signature:
Title: C, Facilities & Transportation Sector, Contracting Officer, JCC – I/A

APPROVAL

Based on the foregoing justification, I hereby approve the award of a new contract with Mid Contracting for construction of the Basra Children's Hospital on an other than full and open competition basis pursuant to the authority of 10 U.S.C. 2304(c)(1), subject to the availability of funds, compliance with Section 2202(a) of Pub. L. 108-106, and provided that the services and property herein described have otherwise been authorized for acquisition.

Date: SEP 18 2006

Signature: _____
Maj Gen Darryl A. Scott
Head of Contracting Activity
Joint Contracting Command –
Iraq/Afghanistan

Chairman TOM DAVIS. Without objection.

Mr. WAXMAN. In this document, the Corps explains why it decided to take Bechtel out of the loop. The document notes that Bechtel "employees state they were unable to visit the project from October 2005 to March 2006." Mr. Mumm, is that true? Were Bechtel employees unable to visit the constructionsite for 6 months?

Mr. MUMM. I can't speak to whether or not those months are exactly right, but I think that what is important to understand about the Basrah Children's Hospital is, first, we were not taken off by USAID. I will come to that in a moment. In fact, what you have to do if you think about Basrah, if I think about the Basrah Children Hospital or Iraq in general, is one has to think about kind of the security environment.

There is nothing more in Iraq that affects both schedule and costs than security. It is both a direct cost and an indirect cost.

Mr. WAXMAN. I understand the security concerns, but the Government was paying your firm to oversee your subcontractors. How could Bechtel provide adequate oversight if its employees were not present at the site for 6 months, is the figure we have? This Army document refers to Bechtel's failure to perform contractually mandated oversight. Do you disagree with the Corps of Engineers that Bechtel failed to perform required oversight?

Mr. MUMM. Yes, in fact we provided the oversight and in fact, if you talk to the Corps of Engineers, what you will see is that we did in fact provide a facility, a structure, the civil and structural work completed in a quality manner. They will tell you that.

Mr. WAXMAN. Well, this document from the Department of Army says the U.S. Army's intent to award this contract to MidCon is occasioned by the U.S. Agency for International Development's decision to stop work on the BCH construction project under its 2004 contract with Bechtel. MidCon was BNI's construction subcontractor on this project. And the justification was the inattentiveness to oversight. It states that Bechtel failed to pay MidCon progress payments in a timely manner. Is that accurate?

Mr. MUMM. We paid MidCon in a timely manner, but we did not pay MidCon for things that MidCon had not completed. I was part of that, Congressman, and was back and forth to Jordan and to Iraq talking to MidCon at every level, trying to get MidCon to continue performing.

I want to go back to the security issue just a moment, if I could.

Mr. WAXMAN. No, I don't want you to because I have some questions. If we have time, I want you to go further into it. But if Bechtel wasn't actually building the hospital, and the question is whether you were overseeing the Jordanian company that was doing the construction, and the claim is that you weren't paying that company on time, why were we paying Bechtel? Wouldn't the Government have been better off to contract directly with the Jordanian subcontractor earlier than it did?

Mr. MUMM. The Government actually, I don't know if they are or not, going to contract with MidCon. MidCon is reluctant to continue. So I am not sure about the document, Congressman Waxman, that you are talking about. I have not seen it. However, the reason we left the project, or are leaving the project and turning it over to the Corps of Engineers, is because there is a real ques-

tion about whether or not, now that the project is in a stable condition, that is the civil and structural work are completed on it, whether or not it should continue, or whether it should sit in abeyance for a period of time, not costing more blood and more money.

We did provide absolute oversight and the quality of the work, and maybe this could be part of the record, the quality of the work will absolutely substantiate that this is a quality installation. Twenty-four people, Representative Waxman, 24 people died getting it to that place.

Our contract ends, period, ends at the end of October.

Mr. WAXMAN. Mr. Mumm, you have to——

Mr. MUMM. OK. I am just keyed up. I am sorry. I am not trying to be rude.

Mr. WAXMAN. As you can see, I have a red light and that means I have a limit on time, and sometimes the witnesses like to get keyed up and run our time out.

Mr. MUMM. Sorry.

Mr. WAXMAN. But this document is from the Department of the Army, and we will certainly make it available to you. I am surprised you haven't seen it, but it is their document of why they decided to abandon you and go to MidCon. You are saying you did a good job. They say you didn't. I would like to see that document and I see no reason why we shouldn't put it in the record.

How much profit did Bechtel make off this project? If you can give me that answer quickly?

Mr. MUMM. One is, we weren't working for the Department of the Army, sir. They didn't make a decision about whether or not to remove us from the project. We instigated the idea.

Mr. WAXMAN. How much profit did you make?

Mr. MUMM. Our profit was not tied to either the cost or the days or the schedule of that particular hospital.

Mr. WAXMAN. If you don't have a number, please get it for me for the record.

Mr. MUMM. We don't have one tied to that. I'm sorry.

Mr. WAXMAN. OK.

Mr. MUMM. Our profit is actually a line item, and it is not tied to the contract.

Mr. WAXMAN. It is a line item in the appropriations?

Mr. MUMM. Yes.

Mr. WAXMAN. This children's hospital was supposed to be a model for Iraq's reconstruction. Instead, it has been a disaster, with cost overruns, schedule delays and absence of oversight. Just in my mind, I have to tell you, there is no wonder this reconstruction is failing. This is what the Iraqi people see, these kinds of projects, these kinds of problems.

Mr. MUMM. What the Iraqi people will see is a quality installation. The Iraqis themselves are afraid to go there and work on this installation. Again, I will reiterate, 24 people died. Our own site security manager was murdered. Our site engineer's daughter was kidnaped and he was forced to go. Our site manager was threatened by two different militia groups. They summarily marched out our electrical mechanical contractor and murdered 12 of them. And you probably saw in the press a few months ago where they took our concrete supplier on one Saturday, the subcontractor providing

the concrete and installing it, they took him out, marched him out and executed 11 of them.

Under those circumstances, what we did in reaction to that was focus very hard on bringing this hospital in, and we accomplished that before our contract finished to a very stable state, and then in a very transparent way, went to USAID and suggested that they take a look at how we go forward with the hospital, which they did. And the decision was made, since our contract was ending, that we would turn that work over to the Corps of Engineers and we have done exactly that.

We have one project that we have not finished in Iraq, and that is it.

Mr. WAXMAN. OK. I am sorry for the losses of people and the difficulties. It is difficult in Iraq.

Mr. MUMM. It is profoundly difficult.

Mr. WAXMAN. Many people have suffered as a result. I want to look at your document. I know what the Army said. It is a question that I think we have to evaluate and I want to do it in a fair way.

Thank you.

Chairman TOM DAVIS. Let me just wrap up, both for Mr. Robbins and Mr. Mumm. How do we stop the kind of problems that we had at the Police Academy? What is the best way to ensure they don't occur? If we can't look to the contractor to produce the result, where are we supposed to look?

Mr. ROBBINS. A very valid question, Mr. Chairman. I think for one thing it goes back to a point that was made I think by the GAO witness this morning about requirements and resources, and I would add time to that. The pressures on all the contractors to complete these projects in time periods far less than it would take to do this kind of work in the United States, let alone when, as Mr. Mumm has so well articulated, and it is true for us as well, when your subcontractors are being intimidated. There is no real rule of law to govern business practices in the country. The amount of oversight is probably much greater, not probably, it is definitely much greater than the Government wants to allow, and in this case, than the Government can guarantee us free access to the job sites.

Chairman TOM DAVIS. How many employees have you lost in Iraq?

Mr. ROBBINS. Fortunately, we have lost none of our U.S. employees. What we have lost, and I don't have an exact count, but I would guess across all of our contracts, at least two dozen Iraqi subcontractor employees. Typically, they are Iraqi citizens.

Chairman TOM DAVIS. Mr. Mumm, how many have you lost?

Mr. MUMM. We have lost people and casualties associated with our work are something about 101. Of those 52 died.

Chairman TOM DAVIS. OK. So it is tough doing business over there, obviously.

Mr. MUMM. I'm sorry?

Chairman TOM DAVIS. It is obviously very, very difficult doing business there, getting continuity, getting workers.

Mr. MUMM. It is difficult doing business there, but we did. We went in. We said what we were going to do with USAID. We had 99 jobs orders and we did every one of them, and we did it in a

way that sustained, and we have provided a platform for the Iraqi people that they could build on if they had a stable environment going forward. We are absolutely proud of what we did, and there is no quality issue.

Chairman TOM DAVIS. Given the difficulties that you have had, do you regret doing business in Iraq?

Mr. MUMM. I'm sorry?

Chairman TOM DAVIS. Do you regret doing business in Iraq in retrospect? Or would you do the same thing over again?

Mr. MUMM. You know, I wish I could tell you. I have lived and breathed Iraq for all these years since after the invasion. I wish I could tell you how emotional I get about this, or just even coming to this hearing today, all the people that wrote to me and said, tell them this, tell them that. All of us feel attached to the Iraqis and to the people there and to the things we did, and we wanted this to work. You cannot imagine the imperative that we felt, the sense of urgency, or the emotional investment and the tearful farewells that we have. Absolutely, I don't regret it.

Chairman TOM DAVIS. Who paid for the security forces for your workers? Did you have to handle that yourself, or were those passed through in the contracts?

Mr. MUMM. It was passed through in the contract, but we managed it ourselves.

Chairman TOM DAVIS. How about you, Mr. Robbins?

Mr. ROBBINS. Sir, on our constructionsites, we actually made site security the responsibility of the Iraqi construction firm that was doing the work. So our security costs reflected only the cost of protection and transportation for our expatriate employees in the Green Zone, and then as they would travel to a job site.

Chairman TOM DAVIS. And you understood, Mr. Robbins, when you took this contract that you would be hiring Iraqis to do most of the work. Wasn't that part of the policy?

Mr. ROBBINS. Absolutely.

Chairman TOM DAVIS. Let me ask you both, what kind of quality have you had out of the Iraqi workers and the subcontractors? I am going to ask you the same thing, Mr. Mumm.

Mr. ROBBINS. First of all, on the one hand, we have 600 Iraqis working side by side with Parsons. So these were people that were actually helping us administer and manage the contracts. When you get 600 people, you will have a lot of good ones and maybe a few not so good. The not so good ones you try to bring along, and if they don't work out, you dismiss them.

But I would echo Mr. Mumm's comments about the dedication and sincerity and hard work, the ethic that these people went through every day just to get to work was mind-boggling. They would have to take a circuitous route, different forms of transportation, then go stand in line at the gate at the Green Zone, at the International Zone, which is the most vulnerable place you could possibly be. You are a target waiting to go through all the detection and inspection necessarily conducted by the U.S. forces guarding it. On the other hand, the subcontractors, when you have 1,700 Iraqi subcontractors, you're going to have some good ones and you are going to have some bad ones.

Chairman TOM DAVIS. Did you have any problems, either one of you, in people that you hired or had access to your sites, of people trying to set it back, blowing it up, or anything else? Any problems with that?

Mr. ROBBINS. You mean sabotage of our work?

Chairman TOM DAVIS. Sabotage.

Mr. ROBBINS. We did, yes, sir.

Chairman TOM DAVIS. You did.

Mr. MUMM. We had no problems with that. We actually instituted this in Iraq. We were the first ones in and we realized we had to go local and go deep, just from all the years that I have spent in the Middle East and Bechtel has. But institutional strength is an important thing. You can bring people on that are bright and energetic, but you need to teach them how to do it the right way, get process and procedure. People don't like that, but you have to get process and procedure in place, and they respond to it. And the Iraqis absolutely responded to it. They are so good that where we can, we are trying to put Iraqis on other work that we have in other places. They are just an outstanding group of people, and no sabotage.

Chairman TOM DAVIS. Maybe you ought to share your list with Mr. Robbins and his group as they go through.

Mr. MUMM. Well, we are very covetous of our people. We hang on to them.

Chairman TOM DAVIS. Mr. Waxman.

Mr. WAXMAN. Mr. Chairman, I am moved by the statements that have been made, how difficult it has been for the contractors in Iraq. But I have to put it somewhat in perspective with Parsons, when we are told that 13 out of the 14 projects were not successful, and the 14th was canceled. We are talking about these two projects today. If those were the only ones, that would be one thing, but when you have so many others.

If we are spending billions of dollars and we don't get anything for that money, we don't get anything that is worthwhile and lasting, it is a waste of money. In Mr. Mumm's cases, for his firm, it was also a waste of many lives.

Now, we are looking at an Iraq that seems to be moving fast to a civil war. If we have had problems up to now, I can't imagine the problems are going to get any easier. No doubt the Iraqi people are looking to find out why we are there, and if we are there to help them be more secure and get on their feet, I don't think we can be judged successful in that regard if we find more and more projects not getting completed.

In fact, I worry about the Police Academy being a symbol for the failure of this country in Iraq. I worry about our failures in the health sector to be a reminder to people in Iraq that we haven't added to their well being. And their electricity and the drinking water, and other things that people want and expect, and don't have on a regular basis, are a reminder to them that we haven't given them what they wanted, other than for most of them, maybe most, or certainly many of them, we got rid of Saddam Hussein, but they want a better life.

So I thank you for this hearing. I think it has been worthwhile. My sympathies go to all the people that are trying under such dif-

ficult circumstances, not just the contractors we hired and then had to pay for their security, and that still wasn't enough, but for all the men and women we sent there who didn't get paid as much as the contractors and subcontractors, but in many cases are going to have to live with the injuries for the rest of their lives, their psychological trauma, and of course, for those who are gone, the families trying to understand the loss in their lives.

That is the only comment I wanted to make.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. I want to thank you for being here today, for being patient with us.

The hearing is adjourned.

[Whereupon, at 1:50 p.m., the meeting was adjourned.]

[The prepared statements of Hon. Jon C. Porter and Hon. Stephen F. Lynch, and additional information submitted for the hearing record follows:]

STATEMENT FOR THE RECORD
CONGRESSMAN JON C. PORTER (R-NV-3)
"Acquisition Under Duress: Reconstruction Contracting in Iraq"
September 28, 2006

Mr. Chairman, I would like to thank you for holding this hearing on the reconstruction contracting efforts in Iraq. I look forward to hearing from the witnesses.

Today, we are here to examine the difficulties our government has faced in attempting to manage, oversee, and coordinate acquisition activities in Iraq. It is no secret that challenges have arisen in trying to complete construction projects.

As a recent GAO report indicates, many problems associated with delayed reconstruction efforts have been based on the Department of Defense's lack of setting a realistic time frame and definite contracting requirements. This inefficiency has often lead to increased costs.

While there are mitigating factors beyond DOD's control such as violence in Iraq and the necessity for consultation with the Iraqi government, we still must take responsibility for any inefficiencies that have occurred and that may occur in the future. We owe it to the taxpayers to ensure that every contract that is established paints the most accurate picture of a realistic timeframe for completion. We must hold every contractor accountable to answer for delays in completing the rebuilding efforts of that nation.

It is incumbent upon each organization, contractor and agency involved to present an accurate picture of the challenges in Iraq. Funding for this project is not boundless. The American taxpayer has not signed a blank check to fund the efforts which are trying to be accomplished and completed abroad. As members of Congress, we owe it to the American public to root out the core issue of concern and help with creating constructive solutions.

Again, Mr. Chairman, I look forward to hearing the testimony from these witnesses and exploring ways in which efforts can be improved to effectively oversee acquisition efforts in Iraq.

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REP. STEPHEN F. LYNCH
COMMITTEE ON GOVERNMENT REFORM
"ACQUISITION UNDER DURESS: RECONSTRUCTION CONTRACTING IN IRAQ"
SEPTEMBER 28, 2006

OPENING STATEMENT

THANK YOU, MR. CHAIRMAN AND RANKING MEMBER WAXMAN, FOR HOLDING THIS HEARING. I'D ALSO LIKE TO THANK ALL OF OUR DISTINGUISHED PANELISTS FOR HELPING THIS COMMITTEE WITH ITS WORK.

MR. CHAIRMAN, SINCE THE MARCH 2003 INVASION OF IRAQ, THE CURRENT ADMINISTRATION HAS EXPENDED OVER $30 BILLION IN U.S. TAXPAYER DOLLARS – AS WELL AS APPROXIMATELY $20 BILLION IN IRAQI MONEY – TOWARDS THE STABILIZATION AND RECONSTRUCTION OF IRAQ.

AMONG THE VARIOUS RECONSTRUCTION PROJECTS THAT WE'VE UNDERTAKEN - FOR THE WORTHY PURPOSE OF PROVIDING HUMANITARIAN ASSISTANCE TO THE IRAQI

PEOPLE - HAVE BEEN EFFORTS TO RESTORE THE COUNTRY'S CAPACITY TO GENERATE, TRANSMIT, AND DISTRIBUTE ELECTRICITY, TO INCREASE OIL PRODUCTION AND EXPORTS, TO ENHANCE CITIZEN ACCESS TO CLEAN WATER AND SEWERAGE SERVICES, AND TO REHABILITATE IRAQI HEALTH FACILITIES.

REGRETTABLY, HOWEVER, THESE GOALS HAVE BEEN SIGNIFICANTLY COMPROMISED BY THE ADMINISTRATION'S GROSS MISMANAGEMENT OF IRAQ RECONSTRUCTION CONTRACTS AND FUNDS – WHICH HAS FACILITATED AN UNPRECEDENTED EXTENT OF FINANCIAL WASTE, FRAUD, AND ABUSE.

IN THIS COMMITTEE, FOR INSTANCE, WE'VE PREVIOUSLY RECEIVED TESTIMONY REVEALING THAT HALLIBURTON HAD ENTERED INTO A VARIETY OF "INFLATED-COST"

SUBCONTRACTS WITH A KUWAITI FIRM, LANOUVELLE GENERAL TRADING AND CONTRACT ING COMPANY.

UNDER ONE SUBCONTRACT, LANOUVELLE WAS CHARGING HALLIBURTON AROUND $1 MILLION PER MONTH FOR LAUNDRY FOR A FACILITY IN KUWAIT AND "*BECAUSE THERE WASN'T VERY MUCH LAUNDRY TO BE DONE, HALLIBURTON WAS PAYING LANOUVELLE AROUND $100 PER 15-POUND BAG.*" UNDER ANOTHER SUBCONTRACT, LANOUVELLE WAS CHARGING HALLIBURTON $55,800 FOR 37,200 CASES OF SODA PER MONTH – YET ONLY ENDED UP DELIVERING A MONTHLY SUPPLY OF 37,200 CANS.

IN ADDITION, WE RECEIVED TESTIMONY REGARDING A KICKBACK SCHEME THAT RESULTED IN THE FEDERAL INDICTMENTS OF JEFFREY MAZON, A FORMER HALLIBURTON PROCUREMANT MANAGER, AND ALI HIJAZI, LANOUVELLE'S MANAGING PARTNER. UNDER THE ALLEGED

SCHEME, LANOUVELLE BILLED U.S. TAXPAYERS MORE THAN $5.5 MILLION FOR WORK THAT SHOULD HAVE COST ONLY $680,000 – A 700% MARKUP FOR WHICH MR. MAZON RECEIVED A $1 MILLION KICKBACK.

AND MOST NOTABLY, PERHAPS, WE SUBPOENAED AND REVIEWED THOUSANDS OF PAGES OF DOCUMENTS FROM THE FEDERAL RESERVE BANK OF NEW YORK – REVEALING AN 11TH HOUR SPENDING SPREE DURING THE FINAL DAYS OF THE COALITION PROVISIONAL AUTHORITY'S EXISTENCE. SPECIFICALLY, IN THE FINAL SIX WEEKS BEFORE CONTROL OF IRAQI FUNDS WAS RETURNED TO THE INTERIM IRAQI GOVERNMENT IN JUNE OF 2004, MORE THAN $5 BILLION IN CURRENCY FLOWED INTO IRAQ UNDER U.S. DISCRETION.

MR. CHAIRMAN, SUCH WASTE, FRAUD, AND ABUSE HAS AMOUNTED TO A LOST OPPORTUNITY TO HELP THE IRAQI PEOPLE AND HAS FRUSTRATED OUR OVERALL POLICY IN

IRAQ – AN UNDERTAKING FOR WHICH WE'VE SACRIFICED A GREAT DEAL FINANCIALLY AND MORE IMPORTANTLY, IN THE LIVES OF OVER 2,700 OF OUR BRAVE MEN AND WOMEN IN UNIFORM.

ACCORDINGLY, I WELCOME THE WITNESSES' PERSPECTIVES ON WHERE WE ARE IN TERMS OF TRACKING THE BILLIONS OF DOLLARS THAT HAVE BEEN MISALLOCATED HERE AND IMPLEMENTING SAFEGUARDS TO ENSURE GREATER TRANSPARENCY AND ACCOUNTABILITY IN THE RECONSTRUCTION EFFORT - AS WE CONTINUE TOWARDS REBUILDING AND STABILIZING IRAQ.

THANK YOU MR. CHAIRMAN. I YIELD BACK THE BALANCE OF MY TIME.

ACCOMPLISHMENTS

TOP USAID STRATEGIC ACCOMPLISHMENTS IN IRAQ

Millions of Iraqis have found their lives transformed by USAID's humanitarian aid and reconstruction efforts throughout Iraq. Since 2003, USAID has been committed to improving the lives of Iraqis, through encouraging economic growth, supporting democracy, rehabilitating health and education systems, providing humanitarian assistance to displaced and vulnerable populations, and restoring and upgrading infrastructure such as electricity, sewage, and access to clean water. This document outlines just a few of the most important accomplishments for the USAID Mission to Iraq.

HEALTH AND EDUCATION

IMPROVING PRIMARY HEALTH CARE:

USAID is helping strengthen essential primary health care services throughout Iraq. In 2005 alone, USAID-supported emergency campaigns immunized 98 percent of Iraqi children between 1-5 years old (3.62 million) against measles, mumps, and rubella. Also in 2005, USAID immunized 97 percent of Iraqi children under five (4.56 million) against polio. In all, USAID partners have trained more than 3,200 Iraqis to expand access to essential primary health care services.

TRANSFORMING PRIMARY EDUCATION:

USAID assistance has helped Iraq move away from rote learning methodology in decrepit, unsanitary classrooms to interactive learning in rehabilitated buildings. Since 2003, USAID has rehabilitated nearly 3,000 schools. Over 20 million new textbooks have been supplied by USAID (8.6 million) and UNESCO (12 million). By mid-2006, more than 133,000 primary school teachers—a third of Iraq's educators in all—will have received training and technical assistance. More than 550 out-of-school youth completed a pilot accelerated learning program. An expanded program, targeting more than 14,000 out-of-school youth, is being implemented during the 2005–06 school year.

RESTORING EXCELLENCE IN HIGHER EDUCATION:

The USAID Higher Education and Development (HEAD) Program brought together five American and 10 Iraqi universities to help reestablish academic excellence in Iraq's higher education system. Between January 2004 and December 2005, more than 1,500 Iraqi faculty and students participated in workshops, trainings, courses and, conferences. University facilities—libraries, computer and science laboratories, lecture halls, and buildings—have been rehabilitated at colleges throughout the country. A mini-grant program supported new, innovative research throughout the country. In addition, the program provided books and electronic resources to university libraries.

INFRASTRUCTURE

EXPANDING ACCESS TO ELECTRICITY:

In 2002 Baghdad had access to electricity on a near continuous basis while the rest of Iraq was limited to 3 to 6 hours daily. The U.S. government has made significant progress in improving electricity supply in Iraq and distributing it more equitably throughout the country. USAID has added 1,292 MW of new or rehabilitated capacity to the electrical grid.

PROVIDING POTABLE WATER:

USAID has refurbished or expanded 19 water treatment plants in five cities in Iraq increasing the supply of potable water to over 3.1 million Iraqis. USAID is also providing plant-level operations and maintenance support at major potable water and sewage treatment plants nationwide to ensure that these plants continue to function. By 2006, water treatment service will be provided to over 3.3 million Iraqis.

RESTORING SEWAGE SYSTEMS:

In 2003 none of the sewage treatment plants in Iraq were functioning properly and the sewage collections systems were in poor condition. This resulted in sewage pooled in neighborhoods and dumped directly into nearby rivers. USAID has refurbished 10 sewage treatment plants in eight cities in Iraq providing sewage treatment to an additional 5.1 million Iraqis, processing 315.3 million gallons daily.

DEMOCRACY AND GOVERNANCE

IMPROVING LOCAL GOVERNANCE AND COMMUNITY DEVELOPMENT:

Iraqi democracy must prove itself through service delivery and community-based solutions to local problems. With USAID assistance, representative provincial and municipal governments are more capable of delivering essential services to their constituents. More than 670

community action groups focused on civic education, women's advocacy, and anti-corruption have been supported by USAID throughout Iraq. Also, working through local NGOs, USAID has implemented 4,672 quick-impact projects in Iraq providing short-term employment and the restoration of basic services.

EXPANDING POLITICAL INCLUSION AND EXPRESSION:

USAID assistance has helped prepare Iraq for two national elections, numerous provincial and municipal elections, and the Constitutional Referendum in October 2005. In preparation for the January 2005 election, USAID helped the Independent Electoral Commission of Iraq (IECI) establish a voter registration system, and worked with the UN on improving balloting procedures. USAID-supported NGOs distributed election materials, helped televise debates, and led over 22,000 town meetings to educate Iraqi voters. Over 15,000 election monitors in the December 2005 elections received training from Iraqi civil society groups and USAID partners.

SUPPORTING THE NEW IRAQI CONSTITUTION:

The January 2005 Interim Government election put into place a National Assembly to frame a constitution emphasizing democracy and the rule of law. USAID partners provided constitutional specialists to the Drafting Committee while input from over 111,000 national surveys kept the Committee in touch with national sentiment. The Iraqi Women's National Coalition, supported by USAID, developed a 10-point statement adopted in the constitution. A USAID-supported NGO televised debates and distributed information. Nearly 9,500 monitors, trained by USAID partners, helped ensure a successful constitutional referendum.

ECONOMIC GOVERNANCE

CONNECTING IRAQ TO THE GLOBAL ECONOMY:

The private sector is the engine for sustainable job creation and economic growth. To help guide policy reform, USAID's Investor Roadmap analyzes constraints to investment. Iraq's Investment Promotion Agency was recently established with USAID assistance and will serve as a resource to international investors. USAID worked with the Ministry of Finance (MoF) to develop a Competitiveness Study, helping integrate efforts to create a robust private sector that fosters job creation.

ENSURING MACROECONOMIC STABILITY:

USAID programs assist Iraq's MoF, Central Organization for Statistics and Information Technology (COSIT), and Iraq's Central Bank in meeting their International Monetary Fund (IMF) requirements. These efforts have helped Iraq earn a $480 million IMF loan (the Stand-by Agreement) in December 2005 as well as expected debt forgiveness of $27 billion from the Paris Club by March 2006. Working with the MoF, USAID introduced the new dinar currency to promote national unity and a sound functioning monetary policy. Currently, 4.62 trillion new Iraqi dinars are in circulation in Iraq.

IMPROVING TRANSPARENCY AND EFFICIENCY:

The Financial Management Information System (FMIS), covering 100 percent of GOI spending units has transformed Iraq's accounting systems from manual to electronically based, improving the transparency and efficiency of Iraq's national financial networks.

EXPANDING PRIVATE SECTOR GROWTH:

To further facilitate private sector growth, USAID, with advisors embedded in 10 key ministries and the Central Bank, has helped to draft and amend dozens of commercial laws that support private sector growth in Iraq. In coordination with the Iraqi government, USAID has helped conduct legal assessments in over 23 economic areas. USAID has furthermore developed strategies to modernize the customs and taxation processes. To facilitate trade in Iraq, USAID established the Trade Information Center which will stimulate trade, create jobs, and offer a full range of services to Iraqi businesses and industry. USAID also provided critical assistance to the Government of Iraq in the preparation of the Memorandum on the Foreign Trade Regime (MFTR) to the World Trade Organization (WTO), marking the start of the accession process.

INCREASING CAPITAL FOR MICRO-, SMALL-, AND MEDIUM-SIZED ENTREPRENEURS:

USAID is increasing access to capital for micro, small, and medium (MSM) entrepreneurs by supporting the establishment of indigenous microfinance institutions (MFIs) in non-permissive areas, in collaboration with the U.S. Military. Two Iraqi MFIs have been established to date and five more are planned.

USAID has also awarded grants to three international MFIs to support microfinance lending in 14 governorates. Grantees have extended 1,812 new loans.

Over 2,436 entrepreneurs from MSM sized businesses (22.6% women) were trained in business skills. USAID approved 350 competitively solicited grants totaling $3 million to provide much needed capital to startup small and medium businesses throughout Iraq.

To further spur bank lending, USAID supported the establishment of an Iraqi Loan Guarantee Corporation.

STRENGTHENING AGRICULTURAL CAPACITY AND PRODUCTIVITY:

The agriculture remains the largest employer in Iraq, currently employing about thirty percent of the labor force, yet it is filled with low-skilled workers with little participation in the country's economic growth. With reform policies and dedicated training to farmers and ministry of agriculture officials, USAID has laid the foundation for extensive agricultural improvements including improved skills and greater productivity.

Some key accomplishments of USAID's agricultural assistance program include:

Wheat Production

USAID has demonstrated for Iraqi farmers a 40% average wheat yield increase over traditional methods by utilizing a cost-effective technical package on test plots in three northern governorates. Additionally, USAID distributed 169 seed cleaners to upgrade wheat seed stock, making over 30,000 tons of cleaned and treated wheat seed available for planting in 2006-2007 season, benefiting over 46,000 wheat-producing farm families around the country.

Livestock Production:

USAID programs deliver the crucial capacity needed to improve the health of Iraq's livestock. To date, USAID has rehabilitated 66 veterinary clinics, responsible for serving almost 5 million animals and 130,000 animal breeders. Additional assistance provided to ensure the health and vitality of livestock includes a vaccination program for over 570,000 sheep against brucellosis in Missan, Dhi-Qar, Qadissiya, Basrah, and Muthanna, reducing incidence of abortion and increasing flock sizes;

Date Palm Production:

Date palm production is an age-old part of Iraq's agriculture legacy. To help revitalize a struggling industry, USAID increased the area of 21 date palm mother orchards to preserve the over 600 varieties of date palms in Iraq from genetic deterioration, and to propagate up to 240,000 commercially viable offshoots per year to increase availability to date producers. Through this type of assistance, USAID replenished the orchards of 120 date producers in Muthanna, Basrah and the Basrah Marshlands with 4,800 date palm offshoots of commercially valuable varieties to increase date production and incomes.

Honey Production

USAID enabled 290 new beekeepers to begin honey production through grants of equipment and training.

The U.S. Agency for International Development has provided economic and humanitarian assistance worldwide for more than 40 years. For more information on USAID's Iraq program, please visit www.usaid.gov/iraq.

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September 2006