

SIGIR Observations

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With 67% of the \$21 billion in Iraq Relief and Reconstruction Funds (IRRF) now expended and only \$2 billion left to obligate, the U.S. reconstruction program in Iraq is fully engaged in project execution and sustainment, contract close-out, and program transition. Effectively advancing the progress of reconstruction and development in Iraq at this critical juncture requires the U.S. government to work closely with the Iraqi government and

international donors to sustain the substantial U.S. investment in Iraq's infrastructure. For this process to succeed, more investment is necessary. To that end, Congress is currently considering a new supplemental funding bill that will support work toward achieving and sustaining U.S. reconstruction goals. The increasing pace of transition in Iraq makes it all the more important that these funds become available soon.

A YEAR OF TRANSITION UPDATE

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

Iraq's new government is re-staffing the 28 ministries responsible for managing government operations. For transition to succeed, Iraq must ensure that its ministries are ready to receive and capably manage completed

projects. U.S. transition plans anticipate this structural development to occur within Iraq's government this year.

Insurgent activity continues to impede ongoing reconstruction projects and interrupt their transition to Iraqi control. But the attacks remain concentrated in a few areas, leaving daily life in much of the rest of Iraq—particularly the Kurdish north and some areas of the south—in a state of gradual recovery. Though recent reports indicate that attacks on infrastructure have abated, Iraq continues to suffer the ill effects of intermittent strikes on key energy nodes.

CRITICAL ISSUE: PROTECTING IRAQ'S INFRASTRUCTURE

In testimony before the Senate Foreign Relations Committee in early February 2006, the Inspector General noted his concern that attacks on Iraq's oil and gas and electrical infrastructures have limited progress in these key sectors. SIGIR subsequently announced and executed, during this reporting quarter, an audit of U.S. programs designed to improve the capacity of Iraqis to protect infrastructure—particularly the critical nodes in the oil and gas sector that have been most subject to attack since 2003. The Inspector General further addressed the matter with U.S. leadership in Baghdad during his eleventh trip to Iraq in February. Recognizing the importance of this issue, the U.S. Ambassador to Iraq has made infrastructure security an essential element of the Embassy Joint Blueprint for Success.

Through April 2006, the United States has invested more than \$265 million to improve Iraq's capability to protect its oil and gas and electricity infrastructures. This investment is mission-critical because insurgent attacks and

criminal sabotage diminish oil and gas production and reduce exports. SIGIR auditors reviewed \$147 million of IRRF and Iraqi funds that supported Task Force Shield, a program established in September 2003 to build Iraq's capacity to protect its oil and gas and electrical infrastructure. Task Force Shield sought to cover 340 key installations, 7,000 kilometers of oil pipeline, and 14,000 kilometers of electrical transmission lines. The audit found that the program failed to adequately meet its goals. For a summary of SIGIR findings, see Section 3 of this Report.

To address this critical issue, the Department of Defense (DoD) recently dispatched a team of experts to Iraq to assess the protection of oil and gas facilities. They examined the sector's infrastructure protection programs, seeking to identify current security challenges. The team is now drafting a strategy that will help the Iraqis more effectively protect their energy infrastructure.

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CRITICAL ISSUE: CLOSING THE RECONSTRUCTION GAP

In its October 2005 Quarterly Report, SIGIR identified a “reconstruction gap,” which acknowledges that—for a variety of reasons, security being the most salient—the U.S. relief and reconstruction program will accomplish less than originally planned. The shortfall in various sectors was caused by more than 250 reprogramming actions, delays driven by security and administrative problems, poorly managed cost-to-complete schedules, and shifting emphases in contracting and program management. Of note, another reprogramming of the IRRF occurred this quarter: \$353 million was shifted from the electricity and health care construction sectors into non-construction programs.

The reconstruction gap, however, comprises more than simply the notion that fewer projects will be completed than expected; it also addresses the shortfall’s impact on outputs and outcomes. Fewer projects completed axiomatically affects infrastructure outputs in Iraq—that is, fewer electrical projects means fewer megawatts on the grid, and fewer oil and gas projects means fewer barrels of oil produced per day. These constrictions have the cumula-

tive effect of slowing improvement in the daily lives of Iraqis.

Ambassador Khalilzad’s initiative to devolve more project decision-making to Iraqis at the local governorate level should help remediate the effects of the reconstruction gap. Iraqis are now exerting a formative influence over project choices. Their management of the process through the Provincial Reconstruction Development Councils, assisted by coalition-staffed Provincial Reconstruction Teams, is building local government capacity in Iraq. The aim of the Ambassador’s initiative is to produce more immediate benefits for Iraqis in every governorate.

The success of the Ambassador’s initiative depends, in part, on new funding. Thus, SIGIR strongly supports the President’s FY 2006 supplemental and FY 2007 budget requests, which propose an additional \$3.2 billion to help secure and sustain Iraq’s critical infrastructure, to build the capacities of national and local governments, and to stimulate economic growth, increased employment, and private-sector development.

CRITICAL ISSUE: ENERGIZING THE OIL AND GAS SECTOR

Iraq has the second-largest oil and gas deposits in the world; revenue from this sector provides 94% of Iraq's national income. Several factors, however, have limited progress in the oil and gas sector: breakdowns in the sector's deteriorated infrastructure, delays in forming the new Iraqi government, uncertainties regarding the legal framework governing Iraq's petroleum industry, and attacks on the sector's critical nodes. The U.S. reconstruction plan allocated 9% of the IRRF for the rebuilding of Iraq's oil and gas infrastructure. Despite U.S. allocations of \$1.7 billion and supplemental Iraqi expenditures, the sector has not returned to pre-war oil production levels. Consequently, Iraq's national income has yet to achieve its great potential, which will be necessary if the country is to fully shoulder its primary role in recovery and reconstruction.

Before the war, it was assumed that:

- Oil and gas revenues in post-war Iraq would pay for much of the reconstruction.
- Foreign private investment in the oil and gas sector would quickly flow into Iraq after the fall of Saddam.

- Post-war Iraq would be sufficiently secure to allow the development of oil and gas without hostile impediment.

To varying degrees, each of these assumptions has not been realized. Continuing attacks on the oil infrastructure have slowed production and cut revenue. Moreover, outside investors have been unwilling to commit capital to this sector until the insurgency abates and a permanent government takes power. Accordingly, the new Iraqi government, which is now forming, can provide necessary certainty by approving and implementing laws that govern foreign investment in the oil and gas sector.

SIGIR recommends that the United States and other donors develop strategies with the Iraqis that will increase oil and gas production and stimulate new capital infusion into the sector. These must include aggressive efforts to curb corruption, which reportedly plagues the oil and gas industry in Iraq. For example, the long-delayed installation of a metering system is essential. Succeeding in these various efforts is critical for Iraq to achieve its enormous economic potential.

CRITICAL ISSUE: BOLSTERING IRAQ'S ANTICORRUPTION EFFORTS

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

The Coalition Provisional Authority (CPA) created the CPI and the IGs specifically to institutionalize anticorruption elements within the new Iraqi government. SIGIR worked at generating support for these institutions early on and continues to highlight the need to support them financially.

Iraq, the United States, and other donors should sustain and increase funding for these

essential institutions. New funding will bolster their effectiveness, while raising general awareness of the new Iraqi government's commitment to fighting corruption. Foreign investment in Iraq may not appreciably increase until Iraq's anticorruption institutions meaningfully investigate and prosecute fraudulent government practices.

SIGIR previously reported that the Department of State (DoS) developed an initiative to strengthen anticorruption efforts in Iraq. Now, at the request of U.S. Embassy-Baghdad, SIGIR and the DoS Office of Inspector General have announced a coordinated survey of the \$365 million supporting U.S. anticorruption programs in Iraq. The survey is intended to assess the initiatives and establish metrics to gauge progress.

CRITICAL ISSUE: ENCOURAGING MORE INTERNATIONAL DONOR PARTICIPATION

As IRRF funds draw down, the role of donor nations will become increasingly important. In Section 2 of this Report, SIGIR provides a detailed history and assessment of non-U.S. donor funding to Iraq.

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

implement pledges and develop, in close coordination with the Iraqis, the way forward for the next phase of reconstruction. Funding is now needed to stimulate the oil and gas sector, which has thus far underperformed for a variety of reasons. SIGIR notes the promising development of an integrated donor database to aid coordinating and deconflicting donor activities, but the system needs more comprehensive inputs from all donors before it can become an effective management tool.

NOTABLE SIGIR ACTIVITIES DURING THIS QUARTER

In the course of performing its oversight function during this reporting period, SIGIR found that the U.S. Ambassador to Iraq, the Commander of the U.S. Army Corps of Engineers Gulf Region Division (GRD-PCO), and the Mission Director of the U.S. Agency for International Development (USAID) have continued to improve management coordination of the Iraq reconstruction program.

SIGIR issued 29 audits and inspections this quarter, which contain 58 new recommendations. Although these audits and inspections

raise a variety of concerns, SIGIR generally found that the likelihood of project success was high when quality control was integrated actively into the project's management and government oversight was consistently disciplined.

Notable SIGIR audits during this reporting period include a performance review of the contract to construct primary health care centers, an audit of reconstruction management information systems, and an examination of the planning and processes for transferring

reconstruction assets to the new Iraqi government. SIGIR's audit of the IRRF-funded primary health care centers contract, summarized in Section 3 of this Report, presents a difficult story. The audit took a comprehensive look at the program and found shortfalls: only 6 of 150 clinics have been completed, although 75% of the funding has been spent. 14 more PHCs will be completed under the original contract, each with construction issues yet to be resolved. The Iraq Reconstruction Management Office (IRMO) estimates that approximately \$36 million will be required to complete 121 partially constructed clinics that were terminated for convenience.

The 13 inspections completed this quarter continue SIGIR's mission to provide on-site assessments of projects in every sector across Iraq. Most of the projects reviewed are still in progress; thus, SIGIR's recommendations may allow for money-saving course-corrections. SIGIR also inspected 55 additional projects through its rapid-review program, using local hires to visit sites that SIGIR inspectors cannot reach. Overall, SIGIR inspectors found that, where management and quality assurance programs were active in the on-site construction process, the quality of work usually met or exceeded contract standards. Moreover, SIGIR believes that the expansive coverage of its inspections teams provides a highly visible deterrent to those who might be inclined to commit acts of fraud, waste, and abuse. Figure 1-1 shows the locations of SIGIR's various inspections across Iraq.

SIGIR investigators are currently work-

ing on 72 open cases involving fraud, theft, bribery, and other alleged crimes. During this quarter, contractor Philip Bloom and former CPA regional comptroller Robert Stein pleaded guilty to conspiracy, bribery, and money laundering in connection with a scheme to defraud the CPA. Bloom now faces up to 40 years in prison and a fine of \$750,000. Under the terms of his plea agreement, he must pay \$3.6 million in restitution and forfeit \$3.6 million in assets.

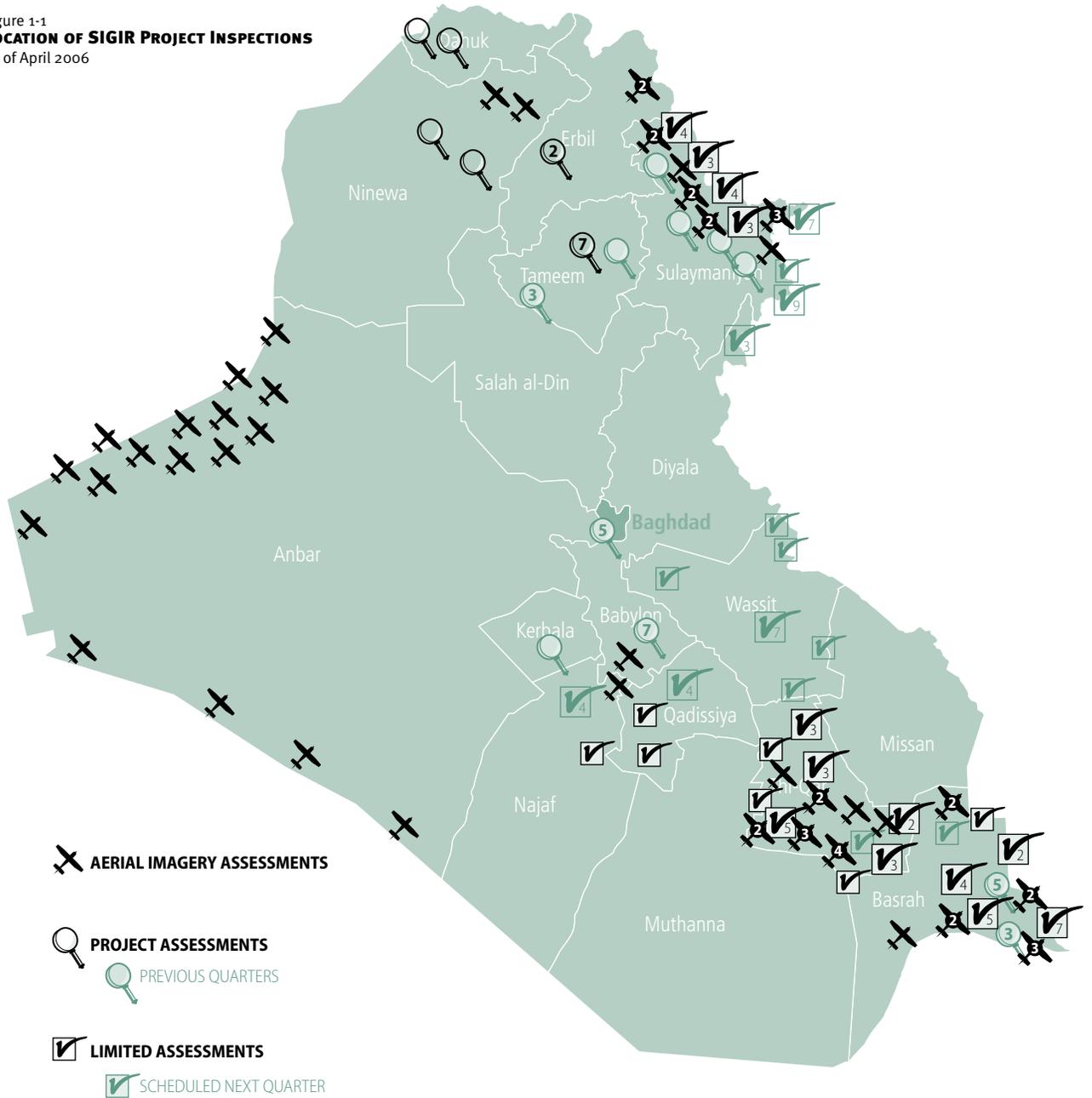
Bloom admitted that from December 2003 through December 2005, he, Stein (who faces 30 years in prison), and other officials conspired to rig bids to ensure that the contracts were awarded to Bloom. The total value of the contracts exceeded \$8.6 million. Bloom admitted paying Stein and other public officials more than \$2 million in bribes.

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

SIGIR continued its Lessons Learned Initiative this quarter, conducting its third forum, which focused on program and project management in Iraq reconstruction. The program and project management report is due for release later this summer. During the next quarter, SIGIR will release its second Lessons Learned report, addressing contracting in Iraq reconstruction. SIGIR's first Lessons Learned report, which examined human capital management, is available at www.sigir.mil.

SIGIR OBSERVATIONS

Figure 1-1
LOCATION OF SIGIR PROJECT INSPECTIONS
 As of April 2006



FINANCIAL IMPACT OF SIGIR OPERATIONS

SIGIR’s oversight has produced tangible financial benefits. SIGIR audits have saved \$10.9 million, recovered \$1.4 million, and improved the use of \$7.8 million. SIGIR challenged payments of \$306.9 million, which included possible duplicate payments, overpayments, and payments for work that was not completed. SIGIR also made recommendations that improved property accountability valued at \$64.8 million. The net potential beneficial

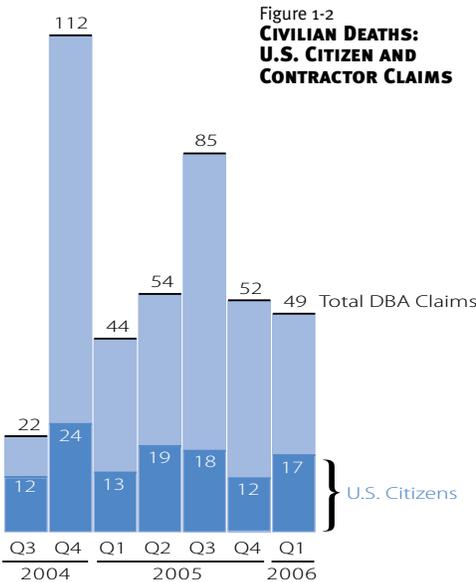
impact of SIGIR’s audits amounts to approximately \$391.8 million, as of December 31, 2005. In addition, SIGIR inspections have produced recommendations that could potentially increase Iraqi oil revenues by \$1.277 billion. SIGIR investigations report that \$13 million in cash and assets have thus far been seized or recovered in the course of its investigations. The data supporting all of these accrued benefits is provided in Appendix I.

THE HUMAN TOLL

The lethal environment in Iraq continues to pose a significant threat to civilians engaged in reconstruction activities. Since the relief and reconstruction effort began in March 2003, 516 death claims for contractors of all nationalities have been submitted under the Defense Base Act (DBA). The Department of Labor reports that death claims over the past four calendar quarters represent almost half (46.5%) of all claims filed over the three years since the war ended in April 2003.

GRD’s daily situation reports regularly summarize attacks at project sites in Iraq. The reports reveal a variety of ongoing threats to contractors in Iraq, ranging from small arms fire to mortars, rockets, and improvised explosive devices (IEDs). Attacks on reconstruction contractors and their security details most frequently occur when personnel are transiting to and from work sites. The death trends noted in prior SIGIR Reports continue: non-U.S. contractors continue to be killed at a faster

rate than U.S. contractors, although there was a spike in U.S. contractor deaths during this reporting period. Figure 1-2 provides a breakout of contractor death totals.



Note: Numbers reported in previous quarters have been updated to reflect recent DoS and DoL reports.

These attacks (and threats of attacks) cause work stoppages and worker absenteeism that push up construction costs. The financial impact is difficult to calculate, but SIGIR believes that delays caused by insurgent activity account for a substantial portion of the total security costs related to Iraq reconstruction.

Security threats vary greatly by region and

type, but all impede progress in Iraq. On March 24, 2006, for example, a project manager in central Iraq received an email threatening that the names, license plate numbers, and other personal information of employees working for the subcontractor would be turned over to assassins who would kill them all. No worker showed up at the site the following day.

