

**Statement for the Record of Michael Thibault  
Deputy Director, Defense Contract Audit Agency  
Senate Committee on Foreign Relations  
7 April 2004**

Mr. Chairman, members of the committee, my statement for this hearing will focus on the Defense Contract Audit Agency's (DCAA) evaluation of contracts awarded under the Iraq Oil for Food program and the financial assistance we have provided in the transition of the Oil for Food program to the Coalition Provisional Authority (CPA).

**Joint DCAA/DCMA Evaluation**

In May 2003, the Under Secretary of Defense (USD) for Policy identified a requirement for an evaluation of approved and funded Oil for Food contracts before transition to the CPA. The Under Secretary of Defense (Comptroller) requested that DCAA support the USD Policy by forming a joint review team led by DCAA and the Defense Contract Management Agency (DCMA). A team of DCAA auditors and DCMA contract specialists began work on the evaluation from mid-May until the end of August 2003. A final report was issued on September 12, 2003.

The primary objectives of the evaluation were to review Oil for Food contracts for price reasonableness and develop recommendations and lessons learned that may be applied to the transition of the Oil for Food program to the CPA. The team reviewed 759 contracts (10 percent of the total 7,591 approved and funded contracts). The 759 contracts were valued at \$6.9 billion, or about 60 percent of the total approved and funded amount of \$11.5 billion. Approximately 80 percent of the contracts reviewed are from Phase 8 or later (from June 2000 or later). Contracts were selected for evaluation to represent the broadest possible range of commodities across all sectors of the Iraq economy. Selections within the different sectors were based on dollar value, priority of goods, past issues with certain suppliers, and the description of the goods to be provided. The State Department worked with the United Nations Office of Iraq Programme (OIP) to provide the review team copies of the selected contracts.

The review team met with representatives from OIP in order to gain an understanding of the review and approval process for the Oil for Food contracts. OIP's primary focus was an administrative/contractual review of the items being purchased from a legal (United Nations Resolutions) perspective. Although OIP informed us that they did, on occasion, raise pricing issues during its review of contracts submitted for approval, validating pricing was not part of their mission since no UN resolution had tasked OIP with assessing the price reasonableness of contracts. Therefore, OIP performed very limited, if any, pricing reviews or cost audits on individual contracts. The DCAA review team was further advised by UN officials that no contracts were disapproved solely based on pricing.

To evaluate the pricing of the selected contracts, the team reviewed the terms of the contract and searched for available pricing information for the goods provided. The type of pricing information the team utilized included:

- World Market prices for food commodities (based primarily on data from the U.S. Department of Agriculture)
- Published Price Lists for the same or similar items
- Vendor quotes for the same or similar items
- Third-party pricing guides, such as Kelly Blue Book
- U.S. Government purchases for the same or similar items
- Published Industry Statistics and Standards
- Internet research for similar private or public sector projects and items

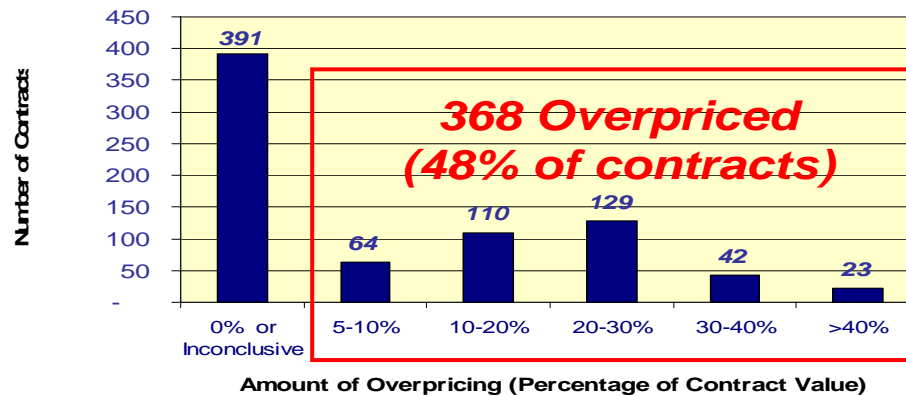
For example, our analysis of food contracts was based on world market prices for the individual commodities (wheat, rice, sugar, etc.). Data, including market prices and transportation costs for most food commodities, is maintained by the U.S. Department of Agriculture. For most of the food commodities, the team was able to obtain market prices specific to the countries and time periods specified in the contracts. The analysis of food commodities also included estimated shipping (including typical insurance costs) to a nearby port and inland trucking costs to points within Iraq. The analysis did not include costs for any potential transportation delay and disruption (demurrage).

The results of the joint team review are shown below:

<b>CONCLUSION</b>	<b>No. of Contracts</b>	<b>Value</b>	<b>Overpricing</b>
POTENTIALLY OVERPRICED	368	\$3.1 Billion	\$ 656 Million
REASONABLY PRICED	347	\$2.7 Billion	
INCONCLUSIVE	44	\$1.1 Billion	
<b>TOTAL</b>	<b>759</b>	<b>\$6.9 Billion</b>	<b>\$ 656 Million</b>

The team noted potential overpricing totaling \$656 million in 48 percent of the contracts evaluated. The team was unable to form a definitive conclusion on 44 contracts, valued at \$1.1 billion because the contracts lacked sufficient detail to make price comparisons to similar goods or the team was unable to obtain independent pricing data for comparable goods.

The review team considered a contract to be overpriced if the overpricing in total exceeded 5 percent of the contract value. The 5 percent reasonableness threshold was selected to assure that any reported potential overpricing was conservatively presented and did not overstate the issue (normally DCAA would take exception to all costs over an estimated reasonable price). A further breakdown of the overpriced contracts is shown below:



Food commodity contracts were the most consistently overpriced, with overpricing identified in 87 percent of the contracts in this category. The potential overpricing by sector is detailed in the following chart:

Sector	Total Contracts		Potentially Overpriced					
	(a) No.	(b) (\$000) Value	(c) No.	(c)/(a) Percent of Contracts <sup>1</sup>	(d) (\$000) Value	(e) (\$000) Overprice	(e)/(d) Percent Overpriced <sup>2</sup>	(e)/(b) Percent of Total <sup>3</sup>
Food	178	2,131,392	155	87%	1,743,404	390,386	22%	18%
Electricity	35	1,225,974	8	23%	134,444	21,245	16%	2%
Transportation	88	595,002	19	22%	134,122	23,543	18%	4%
Vehicles	135	513,426	79	59%	145,860	17,790	12%	3%
Oil	49	611,769	16	33%	162,295	25,845	16%	4%
Agriculture	62	313,056	29	47%	173,312	41,286	24%	13%
Heavy Equip	36	265,950	9	25%	98,281	15,184	15%	6%
Housing	66	451,408	17	26%	173,756	37,991	22%	8%
Water & Sanitation	33	363,657	9	27%	72,705	21,218	29%	6%
Health	55	349,482	17	31%	175,833	39,746	23%	11%
Education	15	87,413	6	40%	58,237	20,425	35%	23%
Miscellaneous	7	31,293	4	57%	30,550	1,259	4%	4%
<b>Total</b>	<b>759</b>	<b>6,939,822</b>	<b>368</b>	<b>48%</b>	<b>3,102,799</b>	<b>655,920</b>	<b>21%</b>	<b>9%</b>

<sup>1</sup> Percent of contracts that are potentially overpriced

<sup>2</sup> Extent of overpricing on overpriced contracts

<sup>3</sup> Extent of overpricing on all contracts

The evaluation team also noted that many of the equipment and vehicle contracts contained unusually large quantities of spares. The team was advised that Iraq often purchased and warehoused large quantities of spares because it was uncertain that they would be able to obtain them in the future if the Oil for Food program expired or if Iraq was otherwise unable to import goods. The team also evaluated 64 contracts that required the sellers to provide, at their own expense, training to Iraqi personnel. The contracts almost always stipulated the duration and location of the training. Generally, the training was to be offered in the supplier's country. In all cases the training was not separately priced. The team also attempted to identify contracts with illicit surcharges ("after sales service charges"). The team found that identifying the existence of surcharges is generally not possible from an examination of the contract documents alone since the contract terms and conditions do not specifically identify the surcharges.

However the evaluation did identify five examples of after sales service charges ranging from 10 to 15 percent.

Finally, the team also identified items of questionable utility for use by the Iraqi people. For example, among the contracts reviewed by the team were two contracts valued at more than \$16 million for high-end Mercedes Benz touring sedans (a total of 300 cars).

### **DCAA Financial Support to the Oil for Food Program Transition**

More recently DCAA has been involved with providing financial advisory services to support the transition of the Oil for Food program to the CPA in Northern Iraq. While DCAA has not performed any audits of the Oil for Food program, the Agency has provided recommendations on strengthening the CPA's Office of Project Coordination (OPC) internal and financial controls. These controls include:

- Recommendations related to inventory controls
- Recommendations related to cash management controls
- Recommendations on management controls and the hiring of key staff positions
- Established procedures to perform bank reconciliations and initial balance sheets

For example, DCAA auditors recently conducted physical perambulations and observations of Oil for Food warehouses in Northern Iraq. The auditors found a range of issues including warehouses without electricity or running water; guards not being paid on time; medicine and drugs being stored in warehouses that do not appear environmentally appropriate for such items; inventory stored in the open air; furniture damaged by being piled into large heaps in an open environment; computers, printers, scanners, copiers, and other office equipment damaged by pigeon droppings. In this example, we believe these obvious inventory control issues are ongoing and need to be addressed by the CPA before the planned transition to the Iraqi Governing Council on July 1, 2004. All DCAA recommendations of this nature have been provided in writing to the Director, CPA Office of Project Coordination.

### **Planned Review of Oil for Food Activities by CPA Inspector General**

Based on a request from Ambassador Bremer, the CPA IG is working to engage an independent accounting firm to review Oil for Food field activities in Iraq. The objectives of the review will center on documenting the internal controls associated with the Oil for Food program, assist CPA officials in effective discharge of their duties, and ensure that CPA oversight promotes effective control at a reasonable price.

The evaluation will be conducted in accordance with International Standards on Assurance Engagements (ISAEs). The review will focus on the key internal control points of the program as requested by Ambassador Bremer:

- Oil for Food Contract Authentication and Payment Process
- Contract Amendment Process
- Potential financial liabilities of the Oil for Food Contracts
- For the OFF North Program – the funding, selection, oversight and administration of the Oil for Food projects

- Safeguarding of all Oil for Food Assets (inventory and cash)
- Identify risk for fraud, waste and abuse

DCAA has worked with the CPA IG to refine the statement of work for the independent accounting firm. The CPA IG wants the work to commence by April 15, 2004. DCAA will act as the Contracting Officer's Technical Representative (COTR). As the COTR, DCAA will monitor the independent accountant's work to ensure compliance with contract terms and the quality of the final work product.

### **Closing**

In closing I want to underscore that DCAA is committed to supporting the CPA and the CPA IG in transitioning this important program to the Iraqi people. I look forward to addressing whatever questions or comments that you have. Thank you.