Documentation

House Committee Reports Mismangement of Iraq Funds

On June 21, 2005, the first official investigation of massive fraud, waste, and abuse in the U.S. handling of the "Development Fund for Iraq," took place in the House of Representatives under the auspices of the Government Reform Committee's Subcommittee on National Security. The report excerpted here, prepared by the Committee's Special Investigations Division Minority Staff, was released that day. It was requested by Rep. Henry A. Waxman (D-Calif.), who is the ranking member of the Committee. The report is titled "Rebuilding Iraq: U.S. Mismanagement of Iraqi Funds." Footnotes are not included. The full report can be found at www.democrats.reform.house.gov.

Executive Summary

Between March 19, 2003, when U.S. forces invaded Iraq, and June 28, 2004, when the U.S.-run Coalition Provisional Authority [CPA] turned power over to the interim Iraqi government, U.S. officials disbursed or obligated over $19.6 billion in Iraqi funds. The vast majority of these funds were withdrawn from the Development Fund for Iraq, the successor to the UN Oil for Food Program, while others came from frozen and seized Iraqi assets. Yet despite the magnitude of the sums involved, there has been little scrutiny of how U.S. officials managed the Iraqi assets entrusted to their care.

At the request of Rep. Henry Waxman, this report examines U.S. management of these Iraqi funds. It is based on a review of over 14,000 pages of financial records and other documents from the Federal Reserve; over 15,000 pages of documents from the Department of Defense; audit reports from the Special Inspector General for Iraq Reconstruction, the Defense Contract Audit Agency, the Government Accountability Office, and other auditors; and interviews with auditors, federal officials involved in the management or disbursement of the Iraqi funds, and Iraqi officials.

The report has three principal findings: (1) unprecedented sums of cash were withdrawn from Iraqi accounts at the Federal Reserve Bank in New York and transferred to U.S. officials at the CPA; (2) CPA officials used virtually no financial controls to account for these enormous cash withdrawals once they arrived in Iraq; and (3) there is evidence of substantial waste, fraud, and abuse in the actual spending and disbursement of the Iraqi funds.

Billions in Cash Withdrawals

The documents from the Federal Reserve indicate that the United States shipped nearly $12 billion in U.S. currency to Iraq between May 2003 and June 2004, an international currency transfer of unprecedented scale. The cash was drawn from accounts containing revenues from sales of Iraqi oil and frozen and seized assets of the former regime.

Nearly half of the currency shipped into Iraq under U.S. direction—more than $5 billion—flowed into the country in the final six weeks before control of Iraqi funds was returned to the interim Iraqi government on June 28, 2004. In the week before the transition, CPA officials ordered the urgent delivery of more than $4 billion in U.S. currency from the Federal Reserve, including one shipment of $2.4 billion—the largest shipment of cash in the bank's history.

In total, more than 281 million individual bills—including more than 107 million $100 bills—weighing 363 tons were shipped to Iraq.

Lack of Financial Controls

Once the cash from the Federal Reserve arrived in Iraq and came under the control of U.S. officials at the Coalition Provisional Authority, the cash was spent and disbursed with virtually no appropriate financial controls.

Under the terms of the UN resolution creating the Development Fund for Iraq [DFI], the fund was to be used "in a transparent manner to meet the humanitarian needs of the Iraqi people . . . and for other purposes benefitting the people of Iraq. But no certified public accounting firm was hired to audit disbursements, and hundreds of millions of dollars in overcharges were withheld from international auditors. According to the Special Inspector General for Iraq Reconstruction, U.S. officials cannot account for the spending of billions of dollars in cash.

An official involved in the spending and disbursement of the Iraqi proceeds described an environment awash in $100 bills. One contractor received a $2 million payment in a duffel bag stuffed with shrink-wrapped bundles of currency. Auditors discovered that the key to a vault was kept in an unsecured backpack. They also found that $774,300 in cash had been stolen from a vault. Cash payments were made from the back of a pickup truck, and cash was stored in unguarded sacks in Iraqi ministry offices. One official was given $6.75 million in cash and ordered to spend it in one week, before the interim Iraqi government took control of Iraqi funds.

Evidence of Waste, Fraud, and Abuse

Because of the lack of proper financial controls, there is no reliable accounting of how the Iraqi funds under U.S. control were spent or disbursed. There is, however, evidence that the expenditure and disbursement of these funds was characterized by significant waste, fraud, and abuse.

Examples of wasteful and potentially corrupt spending include the following:

• The largest single recipient of Iraqi funds is Halliburton, which received $1.6 billion in Iraqi oil proceeds under a contract to import fuel and repair oil fields. According to DCAA [Defense Contract Audit Agency] auditors, Halliburton's overcharges under this contract are more than $218 million.

• An inexperienced but politically connected security firm, Custer Battles, received over $11 million in Iraqi funds, including over $4 million in cash. The company has been barred from receiving federal contracts and faces a False Claims Act lawsuit for multiple fraudulent billings.

• Over $600 million in cash was shipped from Baghdad to four regions in Iraq to allow commanders flexibility to fund local reconstruction projects. An audit of one of the four regions found more than 80% of the funds could not be properly accounted for and that over $7 million in cash was simply missing. . . .

Need for Further Investigation

The findings in this report underscore the need for a comprehensive investigation into how the United States spent and disbursed billions of dollars in Iraqi funds. There is substantial evidence of widespread mismanagement, waste, and corruption in the spending and disbursement of over $19.6 billion in Iraqi funds during the period of U.S. control. The full extent of the waste, fraud, and abuse will not be known without additional investigation. . . .

III. Findings

A. The Federal Reserve Shipped Nearly $12 Billion in U.S. Currency to Iraq

The Federal Reserve shipped $11,981,531,000 in U.S. currency to Iraq between May 2003 and June 2004, according to documents from the Federal Reserve Bank of New York. The cash was drawn from the DFI and TSPA accounts containing revenues from sales of Iraqi oil and frozen and seized assets of the former regime. The CPA also controlled $926,700,000 in U.S. currency seized within Iraq, mainly from the vaults of the former regime.

This currency was shipped to Iraq on pallets loaded into C-130 cargo planes. A standard pallet of U.S. currency contains 40 cashpaks of 16,000 bills each and weighs 1,500 pounds. In the 13 months that the United States administered the DFI and TSPA, 484 pallets containing 19,360 cashpaks were shipped from New York to Iraq. These pallets held more than 281 million individual bills, weighing 363 tons. In total, the U.S. shipped to Iraq more than 107 million $100 bills.

According to internal Federal Reserve Bank records, CPA officials who controlled the DFI and TSPA ordered an initial shipment of currency to Iraq in April 2003, comprising

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More than 281 million bills, including more than 107 million $100 bills, were shipped to Iraq—weighing 363 tons, and without much disbursement control.

$20,008,000 in $1, $5, and $10 bills. Over the next two months, the shipments became larger: $179,340,000 in May 2003 and $465,920,000 in June 2003. Cash shipments from New York into Iraq continued at an average rate of once or twice a month for the rest of the year: $391,200,000 in July, $808,200,000 in August, $400,000,000 in September, $463,975,000 in October, and $500,000,000 in November.

The Dec. 12, 2003, shipment was markedly larger—$1.5 billion—and was described by a Federal Reserve official in an e-mail message as "the largest pay out of U.S. currency in Fed history."

In 2004, the shipments became more regular. The records show shipments of $750,400,000 in February, March, and April. As the CPA prepared to transfer authority to the interim Iraqi government, however, the scale of shipments increased suddenly and sharply: $1 billion was shipped in May 2004, followed by two massive shipments totalling more than $4 billion in the week before the transfer of sovereignty.

In the words of one Federal Reserve official, "Just when you think you've seen it all . . . the CPA is ordering $2,401,600,000 in currency to be shipped out on Friday June 18th." While the Federal Reserve was preparing this shipment, the CPA pushed back the delivery date, and requested an additional shipment:

"The new date is 22 June departure with arrival/delivery on 23 June. *It is important that we make these dates as we have little flex. HEADS UP!* We are going to request a second mission for a 28 June delivery" [emphasis in original].

A Federal Reserve official confirmed the delivery: "I checked the dates with Col. Davis and yes, they want delivery to Baghdad on Monday [June 28]. However, a Monday delivery to Baghdad would have required the Federal Reserve to take the unusual step of opening its vaults on a Sunday. The Federal Reserve and CPA sought to avoid that problem:

"[T]he CPA is now asking if INSTEAD OF doing the Sunday 6/27 shipment, we can ADD $1 bn to the already-scheduled Tuesday 6/22 shipment. If that is do-able, it avoids the whole Sunday accounting problem. . . but also makes it a *$3 bn* shipment . . . if the USAF [U.S. Air Force] agrees to do it, I would like to give the CPA an answer today on our ability to put another $1 bn in $100's on the plane."

In an e-mail with the subject "RE: Pocket Change," a CPA official again emphasized the need to push the schedule ahead: "We need to work the second mission as originally planned to arrive on 26th if at all possible. The 27th at latest. I am not sure we can get anything in here from the 28th through the 5 July. We have been ordered to limit travel out of the green zone between 28 June and 5 July. I am just hoping we don't have to back this date up."

Ultimately, the last-minute cash was sent to Iraq in two separate shipments: $2,401,600,000 on June 22, 2004, and $1,600,000,000 on June 25, 2004. The $2.4 billion delivered on these days replaced the December 2004 shipment as the largest pay out of U.S. currency in Fed history.

In total, nearly $12 billion in cash flowed into Iraq. Of this amount, nearly half—more than $5 billion—was shipped into the country in the month before the transition. . . .

The last-minute rush to spend Iraqi funds was halted by the Federal Reserve when the CPA transferred sovereignty to the interim Iraqi government on June 28, 2004, two days earlier than had been scheduled. After the transfer on the morning of June 28, CPA officials twice sought additional withdrawals from the Federal Reserve accounts, but these were rebuffed. The documents show that the Federal Reserve took:

"a strong view that effective as of the time AMB Bremer transferred authority (which is being reported in the press as 10:26 a.m. in Baghdad), the CPA no longer had control over Iraq's assets. . . . [S]ubsequent to transfer of sovereignty, COL Davis of the CPA sent us $200 million in payment orders to be executed today in New York. We have informed the Colonel that we are not in a position to honor these instructions. Second, also subsequent to the transfer of sovereignty, COL Davis sent us an instruction to transfer $800 million from the DFI main account into the new DFI subaccount, which we understand informally was created by AMB Bremer to hold funds that are earmarked internally within Iraq for payments connected to existing contracts. We have also informed COL Davis that we are not in a position to honor this instruction either (especially since it would require liquidating $1 billion worth of the CBI's [Central Bank of Iraq] holdings of USG [U.S. Government] securities."

B. The CPA Failed to Provide Adequate Financial or Physical Controls

Once the nearly $12 billion in cash arrived in Iraq, the cash was placed under the control of U.S. officials at the Coalition Provisional Authority. *Contrary to the requirements of the UN Security Council resolution and its own regulations, however, the CPA spent and disbursed the cash without appropriate financial or security controls. According to the Special Inspector General for Iraq Reconstruction, the result is that literally billions of dollars cannot be properly accounted for* [emphasis added].

In June 2003, the CPA issued a regulation requiring that an independent, certified public accounting firm oversee the expenditures of the Iraqi funds. The regulation directed:

"The CPA shall obtain the services of an independent, certified public accounting firm to support the objective of ensuring that the Fund is administered and used in a transparent manner for the benefit of the people of Iraq, and is operated consistent with Resolution 1483."

On April 20, 2004, however, CPA officials reported that the "CPA did not obtain the services of a certified public accounting firm as it was determined that these services were not those required." Instead, the CPA hired an obscure consulting firm called North Star Consultants, Inc., "to promote the effective administration of DFI Funds in a transparent manner for the benefit of the Iraqi people." The firm is so small that it reportedly operates out of a private home near San Diego.

When the Special Inspector General for Iraq Reconstruction audited North Stars work, the Special Inspector General found that North Star did not perform any review of the CPAs internal controls:

"In October 2003, a $1.4 million contract was awarded to North Star Consultants, Inc. that required the contractor to perform a review of internal controls and provide the CPA a written report of their evaluation. The North Star Consultants did not perform a review of internal controls as required by the contract. Consequently, internal controls over DFI disbursements were not evaluated. In addition, the Comptroller verbally modified the contract and employed the contractor to primarily perform accounting tasks in the Comptrollers office."

The CPA also provided inadequate physical controls to safeguard the billions of dollars of U.S. currency shipped to Iraq, according to the Special Inspector General. In an audit report, the Special Inspector General described "several physical safeguard violations" observed during the audit. . . .

The IAMB found similar problems. One audit by KPMG reported that $774,300 in cash had been stolen from one division's vault.

Frank Willis, a former CPA official, provided a first-hand account of the vast amounts of cash flowing through Iraq and the lack of financial and physical controls over the funds. During the second half of 2003, Mr. Willis served in Iraq as

Deputy Senior Advisor to the Ministry of Transportation and Communications and as the CPA's senior aviation official. Mr. Willis explained that under CPA control, a "wild west" atmosphere prevailed and the country was awash in brand new $100 bills.

According to Mr. Willis, when contractors needed to be paid by the CPA, they were told to "bring a big bag" for a cash payment. Mr. Willis personally witnessed a $2 million payment to contractor Custer Battles in shrink-wrapped stacks of $100 bills retrieved from a vault. . . .

The Special Inspector General for Iraq Reconstruction reported that cash payments to Iraqi contractors and Iraqi ministries similarly lacked physical security. According to the Special Inspector General, cash payments to contractors were made from the back of a pickup truck, and cash was stored in unsecured gunnysacks in Iraqi ministry offices.

Controls appeared to break down completely in the final days of CPA authority, just as billions of dollars in cash were being rushed into the country. A Special Inspector General audit found that CPA staff members were encouraged to spend cash quickly in its last days before the interim Iraqi government took control of the funds. In the South-Central region of Iraq, one disbursing official was given $6.75 million in cash on June 21, 2004, "with the expectation of disbursing the entire amount before the transfer of sovereignty" on June 28, 2004.

The end result is that billions in Iraqi funds spent or disbursed by the CPA cannot be accounted for. The Special Inspector General concluded that "the CPA did not establish or implement sufficient managerial, financial, and contractual controls to ensure DFI funds were used in a transparent manner" and that funds were "susceptible to waste, fraud, and abuse.". . .

C. There Is Mounting Evidence of Extensive Waste, Fraud, and Abuse

Due to the lack of proper controls, there is no reliable accounting of how the $19.6 billion in Iraqi funds was spent and disbursed during the period of U.S. control. There is, however, growing evidence that there was significant waste, fraud, and abuse of these Iraqi funds. Multiple audits of specific expenditures have found mismanagement, wasteful spending, and fraud.

1. Overcharges by Halliburton

The largest single recipient of DFI funds is Halliburton. Under a no-bid, monopoly contract with the U.S. Army Corps of Engineers, a Halliburton subsidiary, KBR, was paid approximately $2.5 billion for the importation of fuel for the Iraqi people, the preparation of oil field damage assessments, and the repair of oil facilities. Of the $2.5 billion Halliburton received, $1.6 billion came from Iraqi funds from the DFI.

Halliburton's work in Iraq has been plagued by overcharges. According to audits prepared by the Defense Contract Audit Agency (DCAA), the company's overcharges under the oil contract exceed $218 million. Of this amount, $177 million in overcharges were paid from funds in the DFI. . . .

DCAA also detailed numerous specific problems with Halliburton's charges. The agency found that Halliburton had failed to demonstrate that its prices for Kuwaiti fuel were "fair and reasonable" and had failed to negotiate better prices with its Kuwaiti subcontractor. In addition, Halliburton repeatedly refused to provide information requested by DCAA auditors, including its actual costs for fuel from Turkey and Jordan and the process it used to choose its Kuwaiti subcontractor.

Although Security Council Resolution 1483 requires "transparency," U.S. officials affirmatively sought to withhold information about Halliburton's overcharges from the IAMB. After failing for months to respond to repeated requests by the IAMB for DCAA's audits, U.S. officials finally provided the IAMB with "redacted copies of the DCAA audit reports on sole sourced contracts, at its meeting in October 2004." These audits were so heavily redacted, however, as to be nearly meaningless. Every reference to every overcharge in every audit submitted to the IAMB was blacked out. In total, references to overcharges and other questioned costs were redacted 463 times by Halliburton and U.S. officials.

2. Fraud by Custer Battles

In July 2003, a newly formed U.S. security firm with political connections, Custer Battles, was awarded a $16.8 million sole-source contract to provide security at Baghdad International Airport. In August 2003, the company also received a $21.3 million contract to provide security for the exchange of Iraqi currency. One of the principals in the company, Michael Battles, was a Republican candidate for Congress in Rhode Island in 2002 with White House ties. In addition to receiving millions of dollars in wire transfer payments from the DFI, Custer Battles also received over $4 million in cash from the CPA's vault in Baghdad. . . .

The performance of Custer Battles appears to be rife with waste, fraud, and abuse. In just one example, Custer Battles allegedly seized forklifts from Baghdad airport abandoned by Iraqi Airways, repainted them to cover the Iraqi Airways markings, claimed the forklifts were owned by a Cayman Islands shell company created by Custer Battles, and billed the government to lease the same forklifts under the currency exchange contract.

At a meeting between U.S. officials and Custer and Battles, a Custer Battles representative accidentally left behind a spreadsheet detailing the amounts that Custer Battles had overcharged the government. Government investigators subsequently verified that Custer Battles "fraudulently increased profits by inflating its claimed costs."

The company has been barred from receiving federal contracts, and it is now facing a federal lawsuit under the False Claims Act. . . .