

GAO

Testimony

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Oversight and Investigations
Committee on Energy and Commerce
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FOREIGN MILITARY AID TO ISRAEL

Diversion of U.S. Funds and Circumvention of U.S. Program Restrictions

Statement by
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Mr. Chairman and Members of the Subcommittee:

We are here today to testify about a diversion of U.S. foreign military assistance funds and certain abuses of the assistance program. You requested that we investigate Pratt & Whitney and other U.S. companies allegedly involved in diverting and disposing of U.S. funds meant for the Israeli military. Your request was prompted by your July 1992 hearings concerning the diversion of military assistance funds by the General Electric (GE) Company. We will make our findings available to the Department of Justice, which has an ongoing criminal investigation into diversions.

The Government of Israel is the largest recipient of U.S. foreign military assistance funds, receiving \$1.8 billion annually. In the late 1980s, the Israeli government spent most of these funds, approximately \$1.5 billion annually, on direct commercial contracts and the remaining \$300 million on Foreign Military Sales.

Direct commercial contracts are between the military assistance recipient--in this case, the Israeli Ministry of Defense (MOD)--and the U.S. defense contractor performing the work. Contracts are managed by the Israeli Defense Mission in New York and involve very little direct U.S. government oversight. The U.S. Department of Defense, primarily through the Defense Security Assistance Agency (DSAA), administers the military assistance program and is responsible for approving Israel's direct commercial contract purchases. Foreign Military Sales, which U.S. agencies manage, are those in which the recipient tasks a U.S. military service or other U.S. government contracting agency to purchase defense equipment for the recipient.¹

In summary, our investigation focused on four sets of transactions--three direct commercial contracts and a Foreign Military Sales contract--involving Pratt & Whitney and its subcontractors. In one set of transactions between 1986 and 1990, we found that Pratt & Whitney and MOD officials helped Israeli Air Force (IAF) officials and others to divert U.S. foreign military assistance funds from their intended use for Israel's military. In a second set, Pratt & Whitney failed to independently verify whether work was performed by an Israeli subcontractor. Circumstances surrounding this work indicate that foreign military assistance funds may have been used in violation of DSAA guidelines. In the third set of transactions, Pratt & Whitney, MOD, and IAF officials circumvented DSAA restrictions on the use of U.S. funding in Israel. The fourth set involved an IAF-directed sole-source subcontract with an Israeli company on a Foreign Military Sale that resulted in a \$1-million cost increase.

¹The Federal Acquisition Regulations and other acquisition controls are generally applied in a Foreign Military Sales transaction. They do not apply to direct commercial contracts.

Specifically, in the first instance, Pratt & Whitney and MOD representatives facilitated the diversion of \$12.5 million of U.S. foreign military assistance funds through an overpricing scheme organized by former IAF Brigadier General Rami Dotan and others. The scheme involved two small Pratt & Whitney subcontractors--Yrretco and Air Tech. Benjamin Sonnenschein operated the companies and transferred some of the companies' excessive profits to Yoram Ingbir, Sonnenschein's relative and a close associate of Dotan's. We could not determine what happened to these funds because we did not have access to records or individuals outside the United States.

In 1986 and 1987, IAF officers and other Israelis directed Pratt & Whitney to award excessively overpriced subcontracts with predetermined prices to Yrretco and Air Tech (see fig. 1). Upon receipt of Yrretco and Air Tech software and equipment, Pratt & Whitney forwarded the products to Israel without inspecting or testing the work. In return, Pratt & Whitney received a 45-percent markup on each subcontract. By Dotan's arrest in October 1990, Pratt & Whitney had paid almost \$6.5 million to Yrretco and Air Tech although the work they had performed was worth less than \$600,000.

- Pratt & Whitney paid Yrretco \$988,000, the directed price--and received a \$400,000 markup--for redeveloping software similar to what Pratt & Whitney had previously developed for \$500,000. After analyzing the project's requirements and using Pratt & Whitney's estimated labor and equipment costs, we determined that the project should have been priced at \$156,000.
- A second Yrretco software project--for an inventory system--could have been obtained commercially for a small fraction of the cost, according to the Yrretco programmer who worked on the project. He joked that the software could have been bought "for \$99." But Pratt & Whitney paid Yrretco \$823,000--the directed price--and received a \$400,000 markup.
- A third software project--to Air Tech, a company that existed only on paper and that had no employees--was also based on already-developed Pratt & Whitney software for retrieving data from aircraft engines. Pratt & Whitney paid Air Tech \$740,000--the directed price--and received a \$360,000 markup. We learned that Pratt & Whitney representatives and Dotan had previously told MOD and IAF officials--the groups that directed the price paid--that the project would cost only \$40,000, less than 4 percent of what Air Tech and Pratt & Whitney ultimately received.
- The only hardware project performed cost Yrretco \$41,000 for ordering and shipping computers and heat-exchanger

equipment to Pratt & Whitney. Pratt & Whitney paid Yrretco \$1,420,000--the directed price. It received a \$600,000 markup--basically for shipping the computers and equipment on to Israel.

We believe that MOD officials were aware of and facilitated these and the other briefly described transactions, which were exploited by Dotan's associates. On several occasions, Pratt & Whitney officials informed the MOD's Defense Mission in New York of the directed subcontracts involving Yrretco and Air Tech. Further, the MOD departed from its standard practice in issuing the \$12.5-million worth of orders to finance the directed subcontracts. The orders either authorized or set prices for the subcontracts that were predetermined by Dotan, instead of being determined through price negotiations or set in accordance with Pratt & Whitney's standard U.S. government prices.

Further, we believe that Pratt & Whitney should have known or strongly suspected that Government of Israel officials and other Israelis were diverting U.S. funds. It had numerous red flags that the directed subcontracts to Yrretco and Air Tech were grossly overpriced and that those companies were closely tied to the IAF. Furthermore, the funding and management of the contracts departed from Pratt & Whitney's normal procedures. Among those red flags,

- At meetings in 1986, Dotan; Ingbir; Harold Katz, an Israeli legal consultant to Pratt & Whitney; and Pratt & Whitney representatives--and at later meetings, IAF and MOD officials and others--predetermined the prices of the Yrretco and Air Tech projects, without regard to the subcontractors' actual costs. These projects later became known within Pratt & Whitney as "Rami's [Dotan's] special initiatives." Pratt & Whitney neither attempted to estimate the true value of the work nor questioned the prices established by the IAF and MOD officials.
- Pratt & Whitney did not confirm the ability of Yrretco to perform the work before issuing its first purchase order to the company in early 1987. If it had checked, Pratt & Whitney would have found that Yrretco had been created by Yoram Ingbir and existed only on paper until Pratt & Whitney subcontracted with it. Indeed, the program manager said that Sonnenschein seemed to have a "lack of business sense." According to Sonnenschein's attorney, Pratt & Whitney assisted Sonnenschein in writing correspondence from the two companies back to Pratt & Whitney.
- The IAF told Pratt & Whitney not to reveal the connections between Yrretco and the IAF outside the company. Internal Pratt & Whitney correspondence written during the period said that the company had "specific

direction from them (IAF) to make no mention of IAF/Yrretco connections..." (Original emphasis.) Inside Pratt & Whitney, Yrretco and Air Tech were sometimes referred to as the "Northern companies" to mask their identity from employees not involved in the projects.

- Pratt & Whitney departed from its standard practice in managing the Yrretco and Air Tech projects. The program manager, for example, prepared price justifications and personally administered the projects instead of involving supporting departments that usually performed these functions.

The second set of transactions occurred in 1985, when Dotan encouraged Pratt & Whitney (Canada) to award two engineering service contracts worth \$250,000 to Yoram Ingbir and his company, Ingbir Engineering (see fig. 2). Pratt & Whitney has no clear idea what services were provided under these contracts. Pratt & Whitney failed to keep accurate books and records and, as a result, lost accountability of the money it paid to Ingbir and his company. The company, therefore, cannot independently support the invoices it submitted to the Israeli Defense Mission for payment in U.S. funds. Because we were unable to determine what happened to the \$250,000, or if the work paid for was accomplished, we do not know if a diversion of U.S. funds occurred.

In the third set of transactions, Pratt & Whitney, MOD, and IAF officials knowingly circumvented DSAA restrictions on the use of foreign military assistance funds to finance engine upgrade work performed in Israel (see fig. 3). DSAA refused to authorize U.S. financing of upgrade work performed by Israeli companies. Instead, the Government of Israel was supposed to use Israeli national funds or U.S. funds set aside for offshore procurements² to finance work done by Israeli companies on this project. Pratt & Whitney subsequently failed to disclose the foreign content of this work to DSAA, as it was required to do under a contract certification the company had signed in 1986.

In the fourth set of transactions, Dotan and other IAF officers directed Pratt & Whitney to subcontract with Ingbir's company on a Foreign Military Sales transaction. This resulted in a \$1-million increase in contract costs--from \$4.3 million on an initial proposal from Bendix to the \$5.3-million total price charged by Bendix and Ingbir's company. U.S. Air Force officials approved this subcontract even after the delays related to Ingbir's

²Of the funds allocated for Israel's direct commercial procurements, the Congress allowed the Israeli government to spend over \$400 million per year on procurements in Israel, or offshore procurements, without the involvement of U.S. contractors.

performance negated the IAF's justification to sole-source the prime contract on the basis of urgency.

In conclusion, we learned that the Israeli government had an indication of problems in the U.S.-financed program as early as 1987. Although the MOD investigated these and other allegations, significant new program controls were not established until 1990, after receiving evidence that Dotan was accepting bribes. In the summer of 1993, DSAA issued a directive announcing the elimination of direct commercial contracts under the Foreign Military Assistance Program.³ DSAA would require that all subsequent funds be allocated through Foreign Military Sales managed by U.S. agencies in an effort to provide better oversight. However, our investigation, along with a previous GAO review,⁴ indicates that Foreign Military Sales are also vulnerable to abuse. The review concluded that U.S. government oversight of both Foreign Military Sales and direct commercial contracts is inadequate to ensure that effective oversight of subcontractors is provided, contractors actually provide the goods and services paid for, and sole-source purchasing is justified.

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This concludes our testimony. We would be pleased to answer any questions the Subcommittee may have.

³The FY 1994 Foreign Operations Appropriations Act contains language directing the Secretary of Defense to delay elimination of direct commercial contracts until the Department of Defense consults with affected parties, certain congressional committees, and appropriate executive agencies.

⁴Military Sales to Israel and Egypt: DOD Needs Stronger Controls Over U.S.-Financed Procurements (GAO/NSIAD-93-184, July 7, 1993).

GAO Diversion Scheme Involving Yrretco, & Air Tech

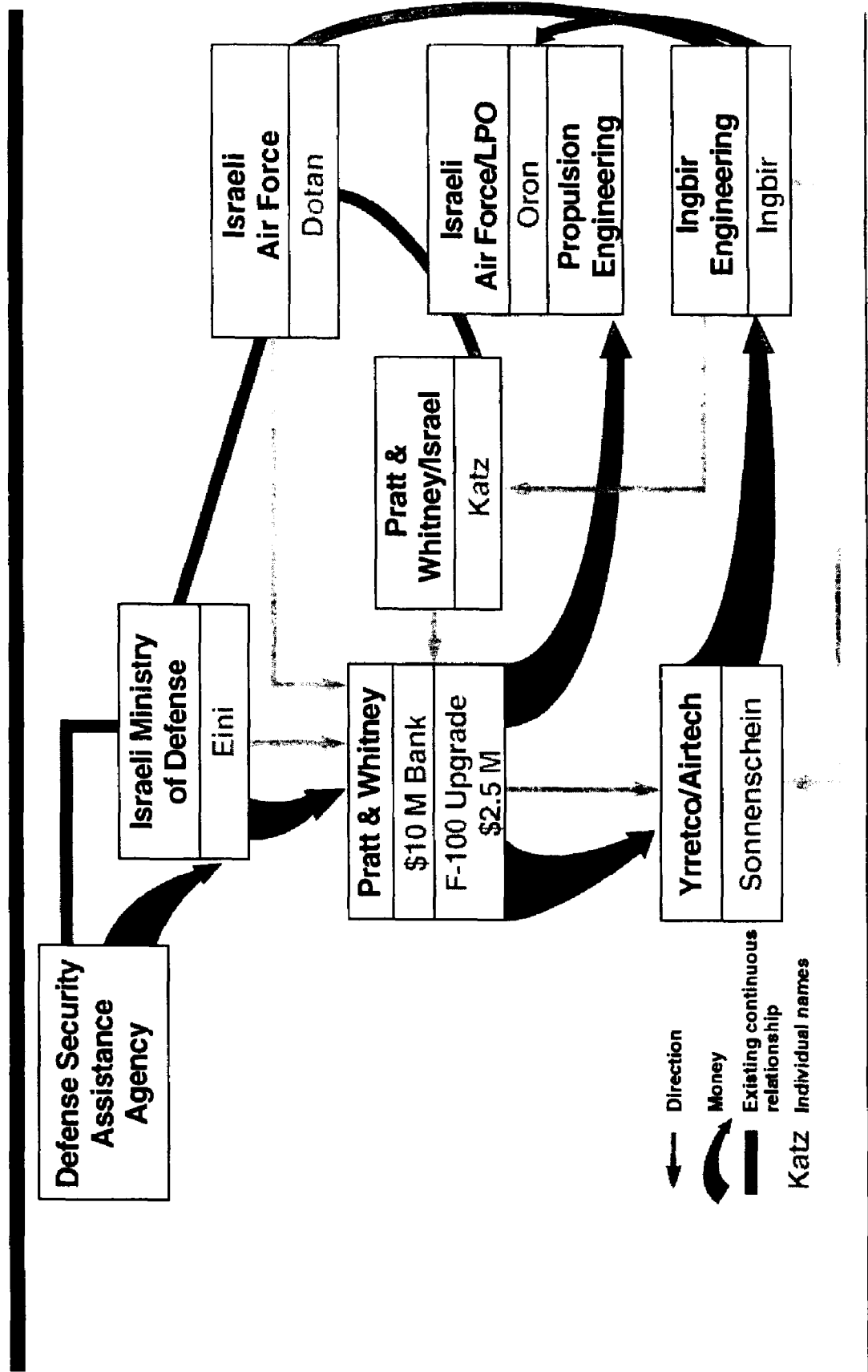


Figure 1

GAO Pratt & Whitney Avoids U.S. Restrictions on Payments to Israeli Companies

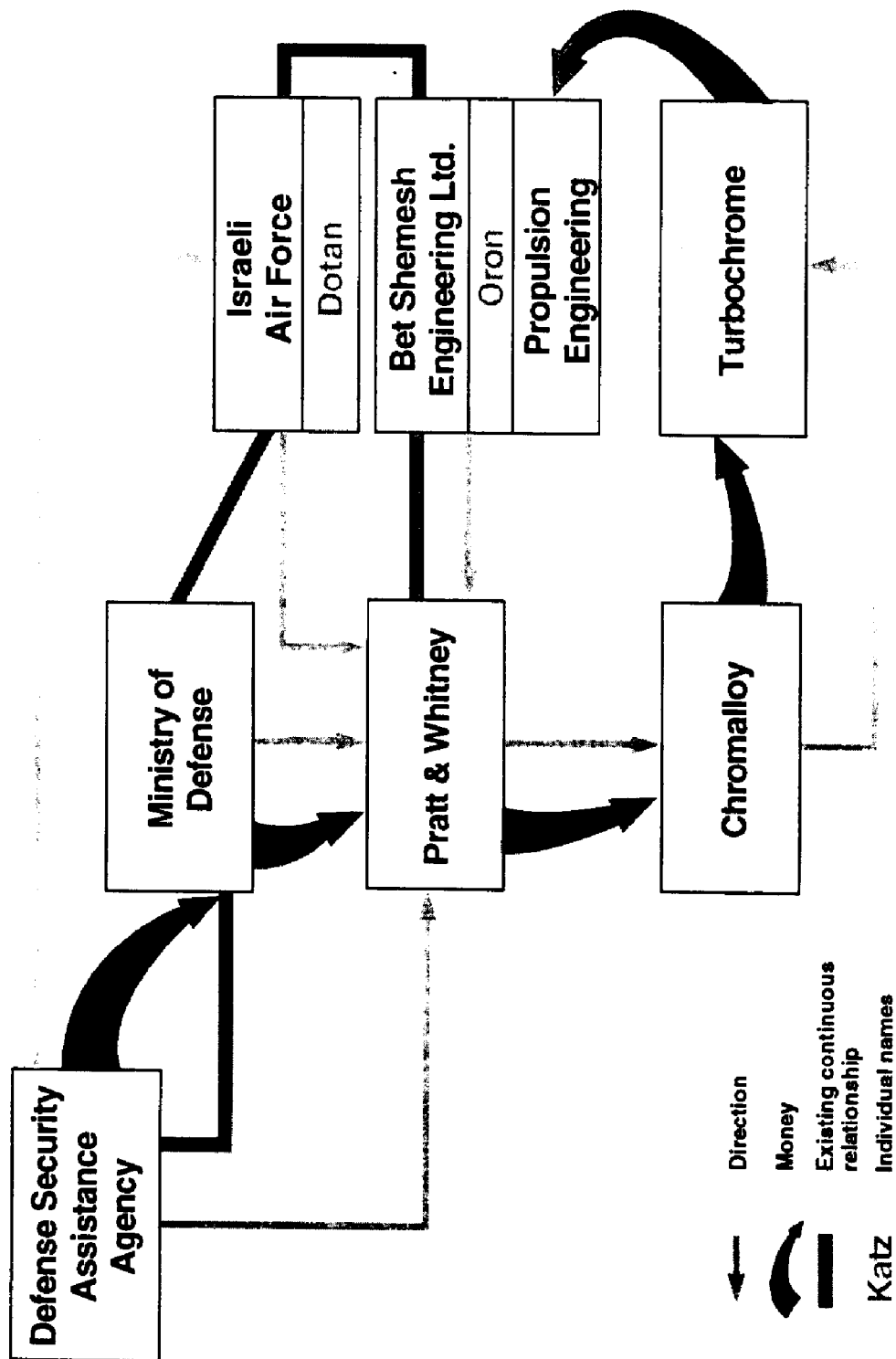


Figure 2

GAO Pratt & Whitney Lost Track of U.S. Funds on Directed Subcontracts

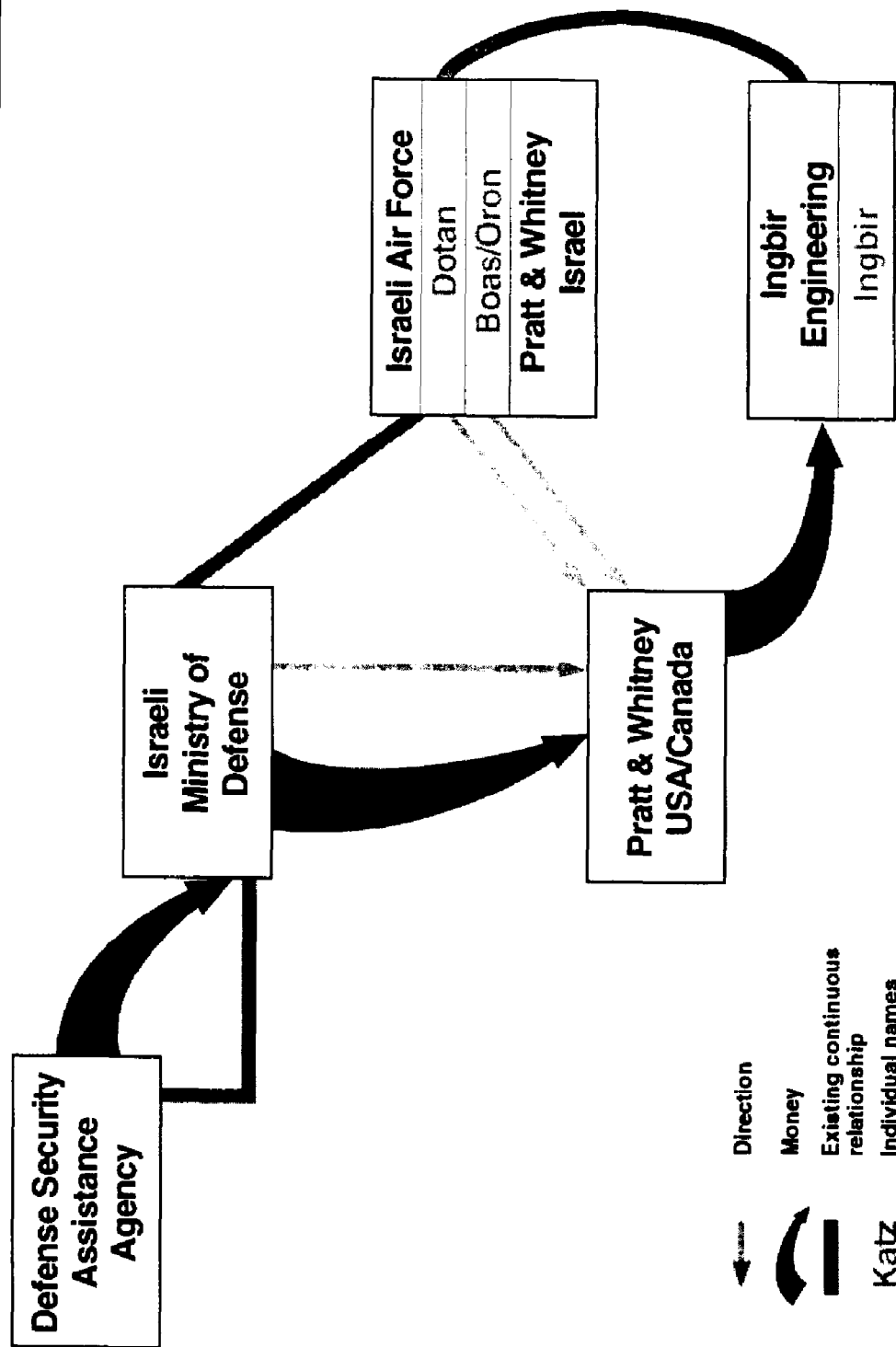


Figure 3

THE FOUR SETS OF TRANSACTIONSDIVERSION OF U.S. FUNDS THROUGH SUBCONTRACTORS

In the first set of transactions, IAF officials and other Israelis directed Pratt & Whitney to use \$12.5 million of U.S. funds to finance grossly overpriced subcontracts with two U.S. companies and to award subcontracts to an Israeli company. Excess profits were then diverted to Israelis involved in the transactions. We could not determine what happened to funds diverted to Israeli participants because we did not have access to records or individuals outside the United States.

During 1986 and 1987, IAF officers and other Israelis directed Pratt & Whitney to award subcontracts with predetermined prices to two U.S. companies--Yrretco and Air Tech of Fair Lawn, New Jersey. The other Israelis included Harold Katz, a legal consultant to Pratt & Whitney, and representatives of Ingbir Engineering, an Israeli company owned by Yoram Ingbir. Yrretco and Air Tech were operated by a relative of Yoram Ingbir, Ben Sonnenschein. Between February 1987 and October 1990, Pratt & Whitney awarded seven subcontracts--six software projects and one hardware project--worth over \$8 million to Yrretco and Air Tech. While Yrretco had employees and office space, Air Tech existed only on paper. Pratt & Whitney was their only client. Pratt & Whitney was also directed to award subcontracts to an Israeli company, Propulsion Engineering, which was owned by a participant in the transactions.

The Diversionary Transactions

The set of transactions involving Yrretco and Air Tech worked as follows (see fig. 1):

- The subcontracts to Yrretco and Air Tech were financed by issuing orders under two existing direct commercial contracts between the Government of Israel and Pratt & Whitney: (1) the F100 Engine Upgrade Agreement and (2) the Lavi Engine Agreement.
- In 1987 and 1988, the MOD and Pratt & Whitney amended the F100 Engine Upgrade Agreement to include two orders worth \$2.5 million primarily for computer software projects. The Israeli Defense Mission in New York and Pratt & Whitney amended the F100 Engine Upgrade Agreement to exclude language that would have required U.S. government prices to be used. The amendment set fixed, predetermined prices instead of allowing for price negotiations.

- In 1987, the Israeli MOD official responsible for the Lavi aircraft program, Menahem Eini, issued four orders worth \$10 million to Pratt & Whitney. These orders were issued under the 1981 Lavi Engine Agreement. Eini directed Pratt & Whitney to spend the money on tasks as directed by IAF officers. Pratt & Whitney then established a so-called "bank," or fund, with the \$10 million; maintained a separate accounting of the funds; and beginning in 1987, financed projects at the direction of IAF officers and others.⁵
- Pratt & Whitney received directions and paperwork from Israelis involved in the transactions, provided this information to Yrretco and Air Tech, and paid the companies. Upon receipt of Yrretco and Air Tech software and equipment, Pratt & Whitney forwarded the products to Israel without inspecting or testing the work. In return, Pratt & Whitney received a 45-percent markup on each subcontract.
- In 1986 and 1987, Dotan, Yoram Ingbir, and Harold Katz figured prominently in directing Pratt & Whitney's actions. These three Israelis had an interest in acting together because they were financially interconnected. Dotan had a secret partnership interest in Ingbir's company. Katz controlled the European bank accounts that held diverted funds for Dotan and others in the GE scheme. We believe Katz also controlled Swiss bank accounts into which U.S. funds were deposited that had been diverted from the transactions we investigated.
- Nehemia Oron, who had directed Pratt & Whitney on the Yrretco and Air Tech projects as an IAF officer, continued to do so after retiring from the IAF in early 1988. Oron provided Pratt & Whitney with the paperwork needed to administer the subcontracts: statements of work, requests for quote, purchase orders, and price justifications. Pratt & Whitney's manager for the F100 projects said that he knew Oron had authority to continue acting for the IAF after his retirement because (1) Dotan referred matters to Oron and (2) IAF officers deferred to him on matters related to Yrretco and Air Tech.

⁵According to a Pratt & Whitney official, the company was not required to submit a contractor certification to DSAA on the Lavi contract. If it was required, he said, the company would have been prohibited from establishing the \$10-million fund. This is because Pratt & Whitney does not have an internal accounting system that tracks advance payments.

- In addition to directing contracts to Yrretco and Air Tech, Oron directed Pratt & Whitney to issue subcontracts to his own company. Pratt & Whitney issued two subcontracts worth over \$200,000 to Propulsion Engineering, Ltd., an Israeli company owned by Oron. The first subcontract was supposed to be financed from the "bank," according to the Pratt & Whitney F100 project manager, because Pratt & Whitney and Oron wanted to use up all of the "bank" funds.
- Excess profits earned on the Yrretco and Air Tech projects were diverted to Israelis involved in the transactions. The operator of the two companies, Benjamin Sonnenschein, pled guilty last year in federal court to currency and income tax violations related to his role in the diversion. According to Sonnenschein's plea agreement and his attorneys, Sonnenschein deposited \$564,000 into banks in New York; Florida; and Zurich, Switzerland, at the direction of Yoram Ingbir. Ingbir was also a central player in the GE scheme. Sonnenschein delivered \$40,000 cash directly to Ingbir and another \$40,000 to a relative of Nehemia Oron. He returned the remaining \$2.8 million of excess profits to the U.S. government as part of his plea agreement.
- With the arrest of General Dotan in October 1990, the transactions ended. By that time, Pratt & Whitney had paid almost \$6.5 million to Yrretco and Air Tech, although the two companies had performed less than \$600,000 worth of work. Pratt & Whitney had also paid Propulsion Engineering \$104,000 on its first subcontract. The second subcontract with the company was canceled before payments were made.

During a recently completed review of controls over U.S.-financed military procurements by Israel,⁶ MOD representatives told our auditors that Dotan had taken advantage of weaknesses in the procurement system. We believe that MOD officials were also aware of and facilitated the transactions exploited by Dotan's associates in this case. On several occasions, Pratt & Whitney officials informed Israeli Defense Mission officials in New York of the directed subcontracts involving Yrretco and Air Tech.

In addition, the MOD departed from its standard practice in issuing the \$12.5-million worth of orders used to finance these directed subcontracts. On the Lavi Engine Agreement, standard practice was for the Defense Mission to direct Pratt & Whitney on project work

⁶(GAO/NSIAD-93-184, July 7, 1993).

and for prices to be in accordance with what Pratt & Whitney would charge the U.S. government. However, Menahem Eini, the MOD Director of the Lavi program, did not define the work to be performed and directed Pratt & Whitney to follow IAF direction in performing the projects. He also instructed Pratt & Whitney to spend the \$10-million in advance payments as directed by IAF officers--thereby authorizing Pratt & Whitney to charge Dotan's predetermined prices. On the orders issued under the F100 Engine Upgrade Agreement, standard practice was for the Defense Mission and Pratt & Whitney to negotiate project prices on the basis of U.S. government prices. However, the MOD amendments to the contract set fixed, predetermined prices instead of allowing for price negotiations.

Projects Directed to Yrretco and Air Tech

Three of the software projects and a hardware project that Yrretco and Air Tech completed were significantly overpriced, creating exorbitant profits that were used for unknown purposes. Military assistance funds were thereby diverted from their intended use of purchasing authorized military goods or services for the Government of Israel. The other three software projects subcontracted to the companies were not completed because Pratt & Whitney canceled them after Dotan's arrest. According to the Yrretco programmer, the canceled projects were also overpriced considering the effort required to complete them.

- The first Yrretco project was based on existing Pratt & Whitney software. Although Pratt & Whitney had developed the entire software for the U.S. Air Force for about \$500,000, it paid Yrretco \$988,000 to perform work on what the Pratt & Whitney manager said was a similar software project. Pratt & Whitney earned over \$400,000 on the \$1.4-million project. The Yrretco programmer initially estimated that the project would require 9 months to complete. GAO conducted its own analysis of the requirements for the project and also estimated that the project should have taken an experienced programmer approximately 9 months to complete. Using Pratt & Whitney's estimated labor costs of over \$15,000 per month and including related equipment costs of \$16,000, the project should have been priced at \$156,000. The Yrretco programmer was earning only \$31,000 per year at the time. Using a standard software costing model and Pratt & Whitney's estimated labor costs, we estimated that the entire project would be worth at most \$400,000 if created from scratch. Pratt & Whitney, however, provided Yrretco with technical and operator manuals for the original Pratt & Whitney software to serve as a basis for the

Yrretco project. This project was financed with funds obtained under the F100 Engine Upgrade Agreement.

- The second software project that Pratt & Whitney awarded to Yrretco was for an inventory system that could have been obtained commercially for much less, according to the Yrretco programmer. The Yrretco programmer said that when he reviewed the requirements for the software, he joked with Sonnenschein that Pratt & Whitney could go to "Egghead Software and buy this for \$99." However, Pratt & Whitney paid Yrretco \$823,000 and earned \$400,000 on this \$1.2-million project. This project was financed from the \$10-million "bank" that Pratt & Whitney had established with the funds obtained under the Lavi Engine Agreement.
- Pratt & Whitney awarded the third project to Air Tech for another software package based on software that Pratt & Whitney had developed for the U.S. Air Force to retrieve data from aircraft engines. Pratt & Whitney paid Air Tech \$740,000 and earned \$360,000 on this \$1.1-million project. The Yrretco programmer, who worked on this project because Air Tech had no employees, thought the project was also very similar to the first Yrretco software package and informed the Pratt & Whitney manager responsible for the work of this similarity. Further, in mid-1984, Pratt & Whitney representatives and Dotan had told MOD and IAF officials that the project would cost only about \$40,000. This project was also financed through the F100 Engine Upgrade Agreement.
- The only hardware project performed by Yrretco and Air Tech cost Yrretco \$41,000 in materials. Sonnenschein simply ordered computers and heat-exchanger equipment and shipped them to Pratt & Whitney. Pratt & Whitney then shipped them on to Israel. For its efforts, Yrretco received \$1,420,000; Pratt & Whitney's markup amounted to an additional \$600,000. This project and the three uncompleted software projects were financed from the \$10-million "bank."

Red Flags Should Have Alerted Pratt & Whitney

We believe that Pratt & Whitney should have known or strongly suspected that Government of Israel officials and other Israelis were diverting U.S. funds. Pratt & Whitney had numerous indications--or red flags--that the directed subcontracts to Yrretco and Air Tech were grossly overpriced and that the companies were closely tied to the IAF. Furthermore, the funding and

management of the contracts departed from Pratt & Whitney's normal procedures. Specifically,

- At meetings in 1986, Dotan, Ingbir, Katz, and Pratt & Whitney representatives--and at later meetings, IAF officials and other Israelis--predetermined the prices of the projects awarded to Yrretco and Air Tech, without regard to the subcontractors' actual costs. Pratt & Whitney made no attempt to estimate the true value of the work, nor did it question the predetermined prices. Indeed, the projects later became known within Pratt & Whitney as "Rami's [Dotan's] special initiatives."
- Pratt & Whitney did not confirm the ability of Yrretco to perform the work before issuing its first purchase order to the company in early 1987. If it had done so, it would have found that the company had been created by Yoram Ingbir and existed only on paper until Pratt & Whitney subcontracted with Yrretco.
- Pratt & Whitney's program manager responsible for the Yrretco and Air Tech projects knew that Sonnenschein was not knowledgeable enough to manage the contracts that Pratt & Whitney awarded to his companies. The program manager said that Sonnenschein seemed to have a "lack of business sense." Indeed, according to Sonnenschein's attorney, Pratt & Whitney assisted Sonnenschein in writing correspondence from the two companies back to Pratt & Whitney. Yet there is no indication that Pratt & Whitney questioned the directed use of his companies.
- Pricing justifications that Pratt & Whitney received from Yrretco and Air Tech exactly matched pricing information that Pratt & Whitney received from representatives of the Israeli government. Pratt & Whitney's manager on the project told us that he assumed Yrretco and Air Tech were in direct contact with the IAF.
- The IAF told Pratt & Whitney not to reveal the connections between Yrretco and the IAF outside of the company. Internal Pratt & Whitney correspondence written during the period said that the company had "specific direction from them (IAF) to make no mention of IAF/Yrretco connections [original emphasis] for security reasons. . . . This project is a commercial contract with the Government of Israel and there will be no interface with U.S. Government AFPRO/DCAA personnel. All contacts on this program should be solely with the F100 Program Office." Inside Pratt & Whitney, Yrretco and Air Tech were sometimes referred to as the "Northern

companies" to mask their identity from employees not involved in the projects.

- Pratt & Whitney departed from its standard practice in managing the Yrretco and Air Tech projects. The program manager, for example, prepared price justifications and personally administered the projects instead of involving supporting departments that usually performed these functions.
- Pricing analyses that Pratt and Whitney relied upon to justify the projects internally were based on Yrretco's having five or more programmers employed. However, Yrretco employed only one programmer until the last 7 months of operation, when a second one was hired. Air Tech had no employees.
- Nehemia Oron's continued role in directing the Yrretco and Air Tech projects was contrary to normal practice; he had retired from the IAF. His role in directing Pratt & Whitney to award subcontracts to his own company was also an abuse of his position. At the same time, Oron was employed as Director of Marketing for Bet Shemesh Engines Limited, an Israeli company 40-percent owned by Pratt & Whitney. Pratt & Whitney was instrumental in placing Oron in the Bet Shemesh position. Furthermore, Pratt & Whitney's program manager reported that Oron had Yrretco and Air Tech letterhead that he used in correspondence with Pratt & Whitney.

Although all indications pointed to a diversion scheme involving Government of Israel and subcontractor personnel, Pratt & Whitney chose to ignore these indicators or acted in such a way that it could avoid notice of the set of transactions. The Pratt & Whitney Executive Vice-President of the West Palm Beach, Florida, facility during this period, in explaining why Pratt & Whitney was reluctant to refuse direction from the IAF, told us that "we [Pratt & Whitney] always try to satisfy the customer." He added that the customer still could go to a company other than Pratt & Whitney for its engines. Pratt & Whitney managers also believed that the rejection of Dotan's directions would have affected the future sales of Pratt & Whitney engines to Israel.

PRATT & WHITNEY LOST TRACK OF U.S. FUNDS ON DIRECTED SUBCONTRACTS

In the second set of transactions, IAF officials directed Pratt & Whitney to award two engineering service contracts worth \$250,000 to Yoram Ingbir and his company, Ingbir Engineering. Pratt & Whitney has no clear idea what services were provided under these contracts. Pratt & Whitney failed to keep accurate books and

APPENDIX I

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records and, as a result, lost accountability of the money it paid to Ingbir and his company. The company, therefore, cannot independently support the invoices it submitted to the Israeli Defense Mission for payment in U.S. funds. Because we were unable to learn what happened to the \$250,000 or if the work paid for was accomplished, we could not determine whether a diversion of U.S. funds occurred.

These transactions can be briefly described as follows (see fig. 2):

- In 1985, Dotan "encouraged" Pratt & Whitney (West Palm Beach) to hire Ingbir Engineering to provide \$154,000 worth of engineering services related to a "miscellaneous flight test support effort" for the Lavi engine in Israel. Dotan also "encouraged" Pratt & Whitney (Canada) in 1985 to hire Yoram Ingbir (as an individual) to provide over \$100,000 worth of engineering services for what was purportedly a classified project.
- Pratt & Whitney did not independently verify that Ingbir Engineering or Yoram Ingbir performed work under the contracts. Instead, it relied on Nehemia Oron and Marc Boas, then IAF officers under Dotan's command, to certify that Yoram Ingbir's and Ingbir Engineering's work on the contracts was satisfactory. At the time, Oron was the IAF manager of the Lavi engine program. Boas' function in the IAF is unclear, but he was accused in the GE case of directing the transfer of funds from GE's subcontractor to European bank accounts.
- In light of the encouragement by Dotan to award the subcontracts to Ingbir and his company, Oron's and Boas' performance certifications appear suspect. Unlike other IAF correspondence to Pratt & Whitney, Oron and Boas did not use IAF or MOD letterhead. Oron's certifications were prepared using a low quality dot matrix printer. Boas' certifications also appear suspect because he transmitted them to Pratt & Whitney via telex from Pratt & Whitney's Israel office and not from his IAF office. Boas' telexed certifications do not include a signature so there is no way to verify authorship. Neither certification discusses the nature or amount of work performed by Ingbir or Ingbir Engineering.
- Pratt & Whitney had no evidence that the prices charged by Yoram Ingbir and Ingbir Engineering were justified, and assumed no responsibility for either direction or acceptance of the work performed. For instance, before paying Ingbir, it did not request or receive engineering

drawings, technical reports, time and expense reports, or other evidence of work accomplished.

The financing of Ingbir's work with U.S. funds on the Pratt & Whitney (Canada) project may also have been prohibited under DSAA guidelines. DSAA generally prohibits the use of U.S. military assistance funds to pay non-U.S. companies for installation design or services. Ingbir's services appear to have been related to the installation of Pratt & Whitney engines in an Israeli power plant. A company representative told us that the project was classified, so Ingbir's function on the project was also classified. But he understood that Ingbir was to provide engineering services related to the interface of Pratt & Whitney PT6A engines and their classified platform. Another company representative said the engines were likely installed in an electric power generating plant, a common application for the PT6A engine. If this is the case, the Government of Israel or Pratt & Whitney should have sought specific DSAA authorization for the use of U.S. military assistance funds on this project.

PRATT & WHITNEY AND GOVERNMENT OF ISRAEL REPRESENTATIVES
CIRCUMVENTED U.S. RESTRICTIONS ON PAYMENTS TO ISRAELI COMPANIES

In the third set of transactions, IAF and MOD officials directed Pratt & Whitney to subcontract work to an Israeli company contrary to contracting directions from DSAA.

DSAA officials told us that they refused to authorize financing of upgrade work performed by Israeli companies with U.S. funds on the F100 Engine Upgrade Agreement because they believed it was similar in nature to overhaul or engine maintenance work. DSAA usually prohibited such labor-intensive work from U.S. financing. The Government of Israel instead was supposed to use Israeli national funds or U.S. funds set aside for offshore procurements to finance work done by Israeli companies on this project.

This circumvention of U.S. restrictions on the financing of upgrade work performed in Israel can be described briefly as follows (see fig. 3):

- DSAA advised the Director of the Defense Mission and the Director of IAF Procurement in a May 1986 meeting and in a June 1986 letter that U.S. funds could not be used to pay Israeli companies for upgrade work under the F100 Engine Upgrade Agreement.
- DSAA also advised Pratt & Whitney's program manager in early 1986 that U.S. funds could not be used to finance upgrade work done by an Israeli company because the work was labor-intensive. Pratt & Whitney certified to DSAA

in 1986 that it would identify either in the Purchase Agreement or in separate documentation to DSAA any non-U.S. goods or services procured under the F100 Engine Upgrade Agreement.

- Both MOD and IAF officials directed Pratt & Whitney to provide upgrade work to Turbochrome, an Israeli company. IAF officials discussed with the Pratt & Whitney program manager the use of Chromalloy Gas Turbine Corporation, Turbochrome's sister company in Oklahoma City, to direct work to Turbochrome. Chromalloy was a Pratt & Whitney subcontractor on the F100 upgrade project.
- Chromalloy was paid \$12,500 per engine to do upgrade work on 105 engines. According to the Pratt & Whitney program manager, Turbochrome was supposed to get up to 40 percent of the value of work on this project.
- Bet Shemesh, the Israeli engine company, tore down the F100 engines and distributed the upgrade work between Israeli companies, including Turbochrome, and Pratt & Whitney.
- Turbochrome performed some work and returned engine parts to Chromalloy, which paid the Israeli company with F100 upgrade funds. However, Israeli companies involved in the F100 upgrade project were supposed to be paid directly by the Israeli government using either Israeli national funds or U.S. offshore procurement funds.
- Pratt & Whitney did not notify DSAA that Turbochrome was being used to perform upgrade work under the F100 Agreement, as required by its DSAA certification; nor did it identify the usage in its invoices to the Israeli Defense Mission.
- Government of Israel officials' direction to provide work to Turbochrome may have been related to Turbochrome's involvement with Propulsion Engineering, Nehemia Oron's company. Turbochrome hired Propulsion Engineering in April 1989 at \$50,000 per year to help it obtain work from the MOD.

COST INCREASE OF \$1 MILLION ON DIRECTED FOREIGN MILITARY SALES CONTRACT

In the fourth set of transactions, IAF officers directed Pratt & Whitney to award a portion of a Foreign Military Sales contract to an Israeli subcontractor, resulting in a \$1-million cost increase over the initial estimate. U.S. Air Force officials approved this

subcontract even after the delays involved in the subcontractor's performance negated the IAF's justification to the U.S. Air Force to sole-source the prime contract to Pratt & Whitney on the basis of urgency.

Dotan and other IAF officers directed Pratt & Whitney to hire Ingbir Engineering to produce two pump modules for two engine-test stands on a Foreign Military Sale managed by the U.S. Air Force. The IAF initially directed the U.S. Air Force to sole-source the contract to Pratt & Whitney to build two new stands, on the basis of an "urgency" justification. IAF officers then directed Pratt & Whitney to hire Ingbir Engineering to build the pump modules.

The U.S. Air Force program manager at the time tried to stop Pratt & Whitney from using Ingbir Engineering. The program manager argued that Ingbir Engineering was unqualified and would cause delays, since the company had never before manufactured pump modules. The manager told Pratt & Whitney that use of Ingbir Engineering was justification to cancel the Air Force's sole-source contract with the company. That decision was overridden by an officer from the office of the U.S. Air Force Chief of Staff, who advised the program manager not to interfere.

Previously, Pratt & Whitney had asked another contractor, Bendix Engine Controls Division of South Bend, Indiana, in early 1987 to provide a quote on the new test stands including pump modules. Bendix offered to do the entire project for \$4.3 million. Bendix estimated that the two pump modules would cost \$1.1 million and the rest of the test stands, \$3.2 million.

In June 1988 Pratt & Whitney awarded the pump module order to Ingbir Engineering for \$1.35 million. According to internal Pratt & Whitney correspondence, the Ingbir Engineering issue resulted in contract delays. In the interim, the original Bendix quote expired. The new Bendix quote, for test stands without pump modules, was for \$3.9 million. The cost for the test stands with Ingbir Engineering pump modules was over \$5.3 million--\$1 million more than the Bendix proposal for the complete assembly.

The majority of the increased cost is attributable to Bendix. Bendix's bid for the test stands without pump modules increased approximately \$800,000 from its original quote to the final quote accepted by Pratt & Whitney. Bendix managers told us they had increased the price because they believed their original bid underestimated the effort required and also because they were to provide assistance to Ingbir Engineering on the pump module project. Bendix visited Israel to attend pump module design reviews, prepared pump module design specifications, and reviewed Ingbir's design for Pratt & Whitney. Ingbir's order accounts for \$250,000 of the increase.

APPENDIX I

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Pratt & Whitney submitted a Form DD 250 to the U.S. Air Force program manager in November 1990 for acceptance of the Ingbir Engineering pump modules. The Form DD 250 is the government inspection and acceptance document that triggers payment to the contractor. It also transfers responsibility for equipment to the U.S. government. However, the U.S. Air Force manager signed the DD 250 in the mistaken belief that it would trigger only payment, not final acceptance. The program manager said that he planned to inspect and accept the pump modules after they were returned to Israel; but as of August 1993, he had not done so. Ironically, a U.S. Air Force manager reported to us that the Government of Israel is unhappy with the pump modules and wants to return them to the U.S. government.

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Our investigation of the Pratt & Whitney transactions illustrates the vulnerability of the foreign military assistance program because of a lack of U.S. control and reliance on the recipient countries to safeguard U.S. funds.

During our investigation we learned that the Israeli government had indications as early as 1987 that problems existed in the U.S.-financed procurement program. Although the MOD later investigated these and other allegations, significant new program controls were not established until 1990, when it had obtained evidence that Dotan was accepting bribes.

- In 1987, Opher Pa'il, a former buyer at the Israeli Defense Mission, sent an anonymous letter to the IAF alleging that Dotan was circumventing procurement controls. Pa'il, at the time, was a marketing representative for U.S. contractors.
- On August 3, 1987, counsel for a New Jersey contractor met with and notified counsel to the Defense Mission that problems existed with IAF procurements. The contractor, who at the time was seeking legal assistance from the Mission, was involved in litigation for having prematurely terminated a representation contract with Pa'il, as directed by Dotan and the Defense Mission Director of Security. During this meeting, the Defense Mission counsel advised the contractor that they were aware that similar problems existed with two other U.S. contractors.
- An Israeli commission reported in 1991 that Israeli police had received a detailed complaint about Dotan in April 1988 but failed to follow up on it.

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- In 1989, Pa'il sent two signed letters to the MOD outlining his complaints and personally discussed his concerns with the MOD Director General. The MOD convened two separate commissions in 1989 to investigate Pa'il's allegations. In September 1989, after the first commission was concluded, Dotan was promoted to the rank of Brigadier General and placed in charge of the IAF Equipment Squadron. The second commission was convened to collect additional information and concluded that a MOD official should continue investigating the allegations.
- In mid-1990, the MOD transferred its investigation to Israeli criminal police. After interviewing Opher Pa'il and obtaining information on the diversion of GE funds to European bank accounts, Israeli police investigated Dotan for bribery and arrested him on October 28, 1990.

In the summer of 1993, DSAA issued a directive announcing the elimination of direct commercial contracts under the Foreign Military Assistance Program. DSAA would require that all subsequent funds be allocated through Foreign Military Sales managed by U.S. agencies in an effort to provide better oversight. However, our investigation, along with a previous GAO review, indicates that Foreign Military Sales are also vulnerable to abuse. The review concluded that U.S. government oversight of both Foreign Military Sales and direct commercial contracts is inadequate to ensure that effective oversight of subcontractors is provided, contractors actually provide the goods and services paid for, and sole-source purchasing is justified.

METHODOLOGY

Our investigation focused on the role of Pratt & Whitney and its subcontractors, but we also considered the involvement of other U.S. companies. We reviewed corporate, banking, telephone, government contracting, and other documents and interviewed company representatives and current and former officials of the U.S. Air Force, U.S. Defense Security Assistance Agency, U.S. Defense Contract Audit Agency, U.S. Defense Contract Management Command, and U.S. Defense Intelligence Agency.

We requested to meet with Government of Israel officials to discuss information they have regarding the diversion of U.S. funds and other abuses of the assistance program. However, the Government of Israel declined to discuss the issues or allow our investigators to question Israeli personnel.

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