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September 7, 2010

The Honorable Robert M. Gates
Secretary of Defense
Pentagon
Washington, D.C. 20301

Dear Mr. Secretary:

I would like to express support for and to offer some suggestions on your ongoing efforts to eliminate wasteful Department of Defense (DOD) spending

In a speech at the Eisenhower Library and Museum on May 8, 2010, you rolled-out your "Efficiency Initiatives." In today's environment, you insisted, "substantial savings" and "real reform" are mandatory: "Given America's difficult economic circumstances and perilous [parlous] fiscal condition, military spending on things large and small can and should expect closer, harsher scrutiny. The gusher has been turned off, and will stay off for a good period of time," you said. To achieve your goal of converting "tail" to "tooth" to provide real growth in combat power, you direct "the military services, the joint staff, the major functional and regional commands, and the civilian side of the Pentagon to take a hard, unsparing look at how they operate – in substance and style alike." Then, on August 16th, you moved your plan to the next level. You created a "temporary" task force made up of DOD officials. Their mission is to root out \$100 billion in wasteful spending.

Mr. Secretary, your pledge to eliminate waste in the DOD budget is music to my ears. But I question the feasibility of your plan. Relying on the Pentagon bureaucracy to eliminate waste is questionable. Those are the very same powerful Pentagon "fiefdoms" that created the problem in the first place and the very same ones that Eisenhower warned us about fifty years ago. Maybe they can find some waste but surely not all of it.

In my respectful opinion, you need a better mix of weapons in your arsenal to get the job done. First, DOD's accounting system is not able to generate accurate financial information. Without reliable financial data, it is difficult to estimate costs and potential savings. You can not make good decisions with bad information. The best available estimates indicate that a modern, fully integrated accounting system will not be in place until 2020 – if then. You may need the likes of Colonel John Boyd to ramrod that operation through to a successful conclusion. Otherwise, it may not happen in our lifetime. Second, you need independent back-up and audit support from the Office of the Inspector General (OIG). Its Audit Office has an annual budget of \$90 million and staff of 765 auditors. Aggressive, hard-core contract audits by that office should be able to find some waste to help close the gap.

While I admit being somewhat baffled by the absence of any reference in your speech to the IG, I think I understand the reason for the omission. By law, the IG is supposed to be the Secretary's – and the taxpayers' -- first line of defense against fraud, waste, and abuse within the department. That is the IG's core mission – root it out and report it to the Secretary or Deputy Secretary of Defense and to Congress. However, I have recently discovered that the OIG Audit Office has strayed far from the core mission spelled out in the IG Act.

Based on a careful review of OIG audit reporting by my staff, I have to conclude that the OIG Audit Office is not well positioned to assist you in your hunt for waste. Beginning in January 2009, I received a series of anonymous letters and reports, alleging mismanagement and low productivity within the OIG Audit Office. In response to these allegations, my staff initiated an in-depth oversight review of all the pertinent issues involved. That report was just completed. I am forwarding a copy for your consideration. The findings summarized below will hopefully help you understand why OIG Audit is not set-up today to fully support your quest for waste. However, with the right guidance and a new direction, OIG Audit should be able to help you find substantial waste.

Root Cause Problem – “No Audit Trail”

Early-on in the review, my staff identified one all-important, central element that is adversely affecting every facet of the OIG audit program -- the DOD's broken accounting system. This dysfunctional system is driving the audit freight train. The success or failure of an audit turns on the quality of financial data available for audit by competent examiners. Unfortunately, the quality of the financial data presented to OIG auditors by DOD during the period reviewed by my staff should probably be rated as poor to non-existent. Having lost control of the money at the transaction level, the DOD's broken accounting system produces inaccurate and incomplete financial data. The consequences are predictable. Most of the time, OIG auditors report “no audit trail” found.

The OIG Audit Office has allowed the “no audit trail” scenario to hinder and, in some cases, to obstruct the completion of credible audits. The situation is so bad that OIG senior managers readily admit that existing audit teams are no longer able to conduct full-scope, end-to-end contract audits. OIG auditors do not verify payments at the primary source – the Defense Finance and Accounting Service (DFAS). “It's impossible We can't do it,” they say. If the OIG Audit Office is not checking payments and matching them with contracts and deliveries, it will never find much fraud and waste. OIG Audit needs to be on the “money trail” 24/7. That is where most fraud occurs. To get contract audit oversight back on track, OIG Audit needs to employ much larger audit teams to tackle DOD's most egregious problems. Today's small teams, consisting of 5 or 10 auditors, are slow to publish reports and are simply not up to the demanding “audit trail reconstruction” task encountered on most jobs.

Instead of searching for fraud on the “money trail,” OIG auditors now frequently review DOD policies and procedures. Such reports yield zero benefits to the taxpayers. They deserve the title: “DOD Policy Police.” Discovering that the DOD IG no longer does genuine contract audits was a startling revelation but one that helps to explain why 765 OIG auditors could not document any measurable fraud in FY 2009.

Until the DOD accounting system is fixed, the department will continue to fight an uphill battle with failing audit opinions on its annual financial statements and a total lack of fiscal accountability.¹ The continuing disconnects between DOD accounting data and OIG audit capabilities disables one of the IG's primary oversight weapons. If audit capabilities are seriously degraded or crippled, as suggested in the attached report, then OIG oversight is gravely impaired, leaving huge sums of the taxpayers' money vulnerable to fraud and outright theft. Just as the department's broken accounting system hinders and obstructs an effective audit function, it will surely hinder and obstruct your efforts to find potential savings. So fixing that system must be a top priority. Not keeping track of dollars and cents is adversely affecting everything DOD does, including your search for waste.

Other important report findings are summarized below:

Downhill Slide in Audit Production and High Costs

- As OIG Audit has shifted away from costly, labor-intensive contract audits to less challenging but academically interesting policy reviews, there has been a drastic, downhill slide in productivity;
- Peak production of 264 reports in 1995 and the near all-time low of 113 reports in 2009 were both achieved with roughly the same number of auditors on hand; In other words, with comparable numbers of auditors, the 1995 audit team was able to produce more than two times as many reports as the 2009 team;
- Productivity figures track closely with report production figures; Peak productivity was 0.42 reports per auditor per year in 1999, which was almost three times greater than the all-time low productivity of 0.147 attained in 2009;
- Productivity comparisons between DOD and other large OIGs showed DOD auditors were out-performed by wide margins; Audit staff at three other large OIGs produced audits at an average rate of .61 audits per year as compared to an average of only .147 audits per year for DOD OIG auditors; Auditors at those three other OIGs appear to be four times more productive than at DOD OIG;²
- Costs for audits differed significantly between these OIGs; The three other large OIGs were able to publish audit reports costing from \$170,000.00 to \$182,000.00; The average cost of a DOD OIG audit was much higher, ranging from \$508,000.00 to \$1,059,000.00;

Outdated and Irrelevant Reports

- OIG Audit takes an average of 17 months to conduct an audit; Some took 30-38 months to finish; Others took so long that they had to be scrapped; Such dated reports lose relevance; Publishing old reports and terminating unfinished ones is also wasteful;

¹ With the application of enough money and manpower, earning clean opinions on very small cross-sections of the DOD financial statement universe is possible but not sustainable until a modern accounting systems is in place.

² This may not be a fair "apples-to-apples" comparison due to differences in mission responsibilities.

OIG Audit Needs to Return to Core Mission

- IG Heddell needs to change the direction of its Audit Office and re-direct its focus back on to the core IG mission: to detect, report, and deter fraud, waste, abuse and outright theft of tax money;

The Secretary of Defense is looking for waste, and the entire OIG Audit Office is AWOL. Its policy audits are largely wasteful and totally out of sync with the present budgetary realities and the department's immediate needs. Mounting pressure to reduce the exploding federal debt will cause some belt tightening at the Pentagon. In fact, Mr. Secretary, your ongoing "Efficiency Initiatives" indicate that belt tightening at the Pentagon has begun. At the same time, there will be pressure for more defense spending, because of reported gaps between the force structure and missions. Either way, cutting waste is essential. OIG Audit should play a constructive role in this process instead of being part of the problem.

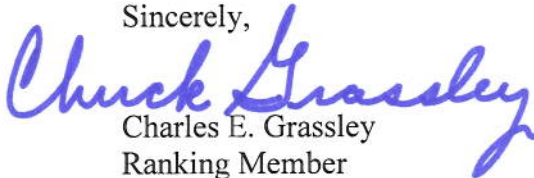
It is therefore incumbent on IG Heddell to re-tool and re-focus the audit effort on priority areas consistent with the core OIG mission as follows:

- **Resume full-scope contract audits to root out fraud, waste, and theft;**
- **Using available manpower, create a small number of much larger audit teams to tackle most egregious contract problems;**
- **Audit plans and programs for fixing DOD's broken accounting system;**

Until a modern, fully integrated finance and accounting system capable of generating reliable information is in place, it will be difficult for top managers to assess "spending on things large and small." It will be difficult for them to accurately identify waste and determine potential savings. In the meantime, OIG auditors must fill in the gaps with labor intensive "gumshoe" audit work. And, above all, OIG needs to start making meaningful recommendations for corrective action. Civilian and military officials, who allow their programs to fall prey to fraud and waste, must be held accountable. Lastly, more audit staff cannot be justified until productivity issues raised in this report are addressed and resolved.

Over the past year, I have repeatedly encouraged the IG to hit the audit reset button. I do it again today in this letter and the attached report. I respectfully request you do the same. Perhaps, together we can get the OIG Audit Office back on the right track.

Sincerely,


Charles E. Grassley
Ranking Member

Copies to:
IG Heddell
Committee on Armed Services
Committee on Homeland Security and Governmental Affairs