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United States Senate

COMMITTEE ON THE JUDICIARY

WASHINGTON, DC 20510-6275

November 20, 2013

Via Electronic Transmission

The Honorable Chuck Hagel
Secretary of Defense
Pentagon
Washington, D.C. 20301

The Honorable Jon T. Rymer
Department of Defense Inspector General
4800 Mark Center
Alexandria, VA 22850

Dear Secretary Hagel and Inspector General Rymer:

I am writing to you today about allegations of misconduct that occurred during audits conducted by the Office of the Inspector General (OIG) at the Department of Defense (DoD). These audits were set in motion by the Chief Financial Officers (CFO) Act.

Several years ago, I launched an oversight review to evaluate OIG's audit capabilities. My inquiry was triggered by whistleblower reports suggesting that those capabilities might be impaired. This was cause for concern. Audits are a primary oversight tool for rooting out fraud and waste and determining whether tax money is spent according to law. To protect the taxpayers, Congress needs to ensure that audit quality is as good as it can be. That does not appear to be the case. After evaluating hundreds of audits, I issued three oversight reports in 2010-12. With a few notable exceptions, I found that OIG audit reports were weak, ineffective, and wasteful, and cost the taxpayers about \$100 million annually to produce.

Furthermore, with mounting pressure for serious belt-tightening under Sequestration, audits have assumed even greater importance. Audits should help senior management separate the wheat from the chaff and apply mandated cuts where they are needed most. Sequestration cuts should be guided by hard-hitting, rock-solid audits. However, as I have reported, rock-solid audits produced by the DoD OIG are scarce. So long as DoD is unable to pass the CFO audit test and accurately report on how it spends the taxpayers' money and audits remain weak and ineffective, the probability of rooting out much fraud and waste during Sequestration remains very low. Effective and aggressive audit reporting is the key to pinpointing and solving long standing accounting problems and eliminating waste.

Starting in April 2012, I began receiving allegations of misconduct regarding two Defense Finance and Accounting Service (DFAS) audits. So I put them under my oversight microscope. I examined the official records of those audits, known as work papers, with the help and guidance of CPA-qualified government auditors. Discoveries in these documents, when coupled with verbal and written interviews of knowledgeable officials, tell the story of what really happened. And it's not a pretty picture. **If** this snapshot is characteristic of the work being produced by that office, we have a problem.

It is important to note right up-front that what occurred on these two audits happened long before Mr. Rymer became Inspector General. But now that he has assumed those responsibilities, he needs to help you determine whether appropriate corrective action is necessary and justified.

In a nutshell, this is what I found:

A certified public accounting (CPA) firm, Urbach, Kahn, & Werlin (UKW), had awarded unqualified or “clean” opinions on financial statements produced by DFAS since fiscal year (FY) 2002. The OIG took a two-year snapshot and examined the firm’s opinions on statements for FY 2008-09. It was supposed to report on whether they met prescribed audit standards, but due to a series of ethical and legal blunders, that job was never finished.

The work performed by DFAS was sub-standard. The outside audit firm rubber-stamped DFAS’ flawed practices using defective audit methods. For its part, the IG was prepared to call foul on UKW for sub-standard work but was steamrolled by DFAS and possibly other forces. The IG failed to do its job. Instead of exposing poor practices by both DFAS and UKW, it tried to cover its tracks. This failure of independent oversight had serious consequences. The contract, the IG Act, and audit standards got trampled, and payments were made to the CPA firm, which were alleged to be improper. The OIG just turned a blind eye to what happened, and the integrity of the audit process was probably compromised.

The bungled audits of the department’s central accounting agency have the potential for undermining the credibility of the Secretary of Defense’s audit readiness initiative and placing it in jeopardy. The goal of this plan, which was announced in October 2011, is to bring the department, the only agency that remains delinquent, into compliance with the CFO Act sooner than the 2017 date mandated by Congress.¹ The unresolved questions about the reliability of DFAS’ financial statements do not augur well for achieving that goal anytime soon. DFAS’ apparent inability to accurately report on its own internal “housekeeping” accounts of \$1.5 billion casts doubt on its ability to accurately report on the hundreds of billions DoD spends each year – as it is required to do under the law. If the department’s central accounting agency can’t earn a “clean” opinion, then who in the department can?

You and the Congress need to know the truth. Did the department’s flagship accounting agency earn a clean opinion, yes or no? The ability of the department to meet the accelerated audit deadlines may depend on the answer to that question. If the department is ever to achieve compliance with the CFO Act, then aggressive and effective OIG oversight is absolutely essential. The OIG and DFAS need to play a leadership role in helping to clean-up the unending DoD accounting mess. Neither agency seems up to the task. Both the OIG and DFAS were deeply involved in this fiasco. This matter needs top-level review.

¹ The audit readiness initiative was launched by former Secretary of Defense Leon Panetta in a memorandum on October 13, 2011 and endorsed by Secretary Hagel in testimony before the Senate Armed Services Committee on April 17, 2013; The goal was to achieve partial audit readiness by late 2014;

The OIG -- the institution that exists to root out fraud, waste and abuse -- appears to have played the role of silent enabler in the alleged misconduct. **If true**, then the OIG clearly demonstrated an unwillingness to perform its core mission. **If true**, the OIG officials directly involved would bear primary responsibility for this unacceptable and inexplicable oversight failure. **If true**, those responsible must be held accountable for what happened. Although this audit failure occurred in 2008-2010, most of the officials involved are still in place.

Based on the findings presented in my report, I offer four recommendations as follows:

First, the DoD CFO should “pull” the DFAS Working Capital Fund financial Statements for FY’s 2008 and 2009 and remove those audit opinions from official records.

Second, the OIG needs to undertake an independent audit of DFAS’ financial statements for FY 2012 and/or 2013 and determine whether those statements and the CPA firm’s opinion report meet government audit standards as required by the IG Act. This work needs to include the verification of the FY 2012 beginning account balances.² The OIG examination should be coordinated with and reviewed by the U.S. Government Accountability Office (GAO).³ Consistent with this recommendation, the OIG has already initiated a “Post Audit Review” of DFAS’ FY 2012 financial statements. And at Senator Grassley’s request, the GAO has agreed to independently validate the results of that work to ensure that it meets all applicable standards. This work is now in progress.

Third, the Inspector General should address and resolve any allegations of misconduct involving DFAS officials and make appropriate recommendations for corrective action;

Fourth, I will refer allegations of misconduct by OIG staff to the Integrity Committee of the Council of the Inspectors General on Integrity and Efficiency for further review and resolution as provided under the IG Reform Act of 2008.

Mr. Secretary and Inspector General Rymer, the findings in the attached report are downright disgraceful. They need and deserve your attention. Your consideration of this matter would be appreciated.

Sincerely



Charles E. Grassley
Ranking Member

Attachment

² AICPA AU Section 315, Communications Between Predecessor and Successor Auditors, Sections .12 and .13;

³ On 1/29/13, the DoD OIG announced that it would conduct a “Post Audit Review” of DFAS’ FY 2012 financial statements; and on 5/14/13, the GAO accepted Senator Grassley’s request for an independent assessment of the OIG’s post audit review to ensure that it meets all applicable standards;