

**OFFICE OF SENATOR CHUCK GRASSLEY**

**STAFF OVERSIGHT REPORT**



**INTEGRITY OF THE AUDIT PROCESS**

**AT**

**DEPARTMENT OF DEFENSE OFFICE OF THE INSPECTOR GENERAL**

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## **Introduction: Audits Are Key To Effective Oversight**

Several years ago, Senator Grassley's staff began evaluating the quality and impact of the Department of Defense (DoD) Office of the Inspector General's (OIG) audit reports. This effort was in response to a steady stream of anonymous reports from whistleblowers, suggesting their force was diminished. These red warning flags triggered a series of oversight reports. After evaluating hundreds of audits, Senator Grassley issued three oversight reports in 2010-12. With a few notable exceptions, Senator Grassley found that OIG audit reports were weak, ineffective, and wasteful and cost the taxpayers \$100 million a year. Then, in April 2012, Senator Grassley's office began receiving allegations of misconduct on audits of financial statements produced by the Defense Finance and Accounting Service (DFAS). To assess these issues, Senator Grassley shifted gears. Instead of issuing another report card on the latest batch of audits, he zeroed in on the two DFAS audits.

DFAS is the DoD financial kingpin. It is the department's flagship accounting agency. It is chiefly responsible for paying the bills and keeping track of all the money. It is also the centerpiece of the Secretary of Defense's audit readiness initiative announced in October 2011. That plan is designed to bring the department into compliance with the Chief Financial Officers (CFO) Act sooner than the 2017 date mandated by Congress. It is alleged that the DFAS audits were deliberately fumbled and fudged, and all the bungling that took place acted to screen pervasive inaccuracies in DoD's financial reports from public view. This failure, in turn, may have placed the Secretary of Defense's audit readiness initiative in jeopardy. 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 DFAS can't pass the CFO audit test, then who in the department can?

The oversight report that follows is a mere snapshot, but if it is characteristic of the work being performed by the DoD OIG's Audit Office, then the department has a problem that needs and deserves top-level management attention. Congress has a responsibility under the Constitution to ensure that the taxpayers' money is not being wasted, and the only way to meet that responsibility is to have independent and effective audit oversight, which is supposed to be provided by the inspectors general. Audits are **THE** primary oversight tool for rooting out fraud and waste and determining whether the money is spent according to law. And with mounting pressure for serious belt-tightening under Sequestration, audits have assumed even greater importance. They should help senior management separate the wheat from the chaff and apply mandated cuts where they are justified. Sequestration cuts should be guided by rock-solid audits. Unfortunately, rock-solid audits produced by the DoD OIG are few and far between. 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.

## 1. Synopsis

This report examines two audits conducted by the Office of the Inspector General (OIG) at the Department of Defense (DoD). A certified public accounting (CPA) firm, Urbach, Kahn, & Werlin (UKW), had awarded unqualified or “clean” opinions on financial statements produced by the Defense Finance and Accounting Service (DFAS) since fiscal year (FY) 2002. The OIG took a 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’ practices using defective audit methods. For its part, the IG was prepared to call foul on UKW for sub-standard work but was somehow steam rolled by DFAS. 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. In the process, the integrity of the audit process was compromised, and the Secretary of Defense’s audit readiness initiative was placed in jeopardy, and the OIG failed to cooperate fully with Senator Grassley’s inquiry.

## 2. Allegations Triggered Inquiry

On April 18, 2012, Senator Chuck Grassley began receiving emails from whistleblowers, alleging gross misconduct in connection with the two DFAS audits as follows:

- A senior OIG audit official, ██████████, “ordered” a subordinate, ██████████,<sup>1</sup> the OIG Contract Officer Representative (COR), to produce an endorsement report on the DFAS’ FY 2008 financial statements despite the lack of appropriate, sufficient audit evidence to support that conclusion;
- Senior management, including ██████████, Deputy ██████████, and Assistant IG ██████████, took “punitive action” against the auditors who produced the non-endorsement report on the FY 2009 opinion;
- ██████████ and Deputy ██████████ instructed a subordinate “to sanitize and alter” the audit work papers in the TeamMate audit management system<sup>2</sup> to “remove anything contentious, including all references to fraud, before the project file was closed;”
- ██████████ and Deputy ██████████ launched a quality assurance review (QAR) in an attempt to discredit the non-endorsement decision and to conceal audit evidence;
- “UKW submitted bills for work not performed using the wire” and DFAS paid those bills – even after being instructed by the OIG COR to reject those invoices for payment based on advice from OIG Legal Counsel;
- DFAS and OIG officials knew the disputed payments to the CPA firm were improper because they covered work not performed, violated the terms of the contract, and might constitute “false claims;”

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<sup>1</sup> ██████████ was responsible for making the decision on whether to endorse the CPA firm’s opinion;

<sup>2</sup> TeamMate provides an automated audit work paper system that documents audit work with links to supporting documentation;

- These improper payments were discussed by senior OIG officials who “elected not to formally report” them;
- ██████████ “cut a deal” with DoD Chief Financial Officer (CFO) Robert Hale to reverse impending OIG budget and staff cuts in exchange for suppressing the non-endorsement report on the UKW opinion;
- The OIG, CFO and DFAS “conspired to conceal gross errors, material internal control weaknesses and insufficient audit work by UKW,” to spare CFO Hale and DFAS further embarrassment for DoD’s continuing accounting mess;
- The confidentiality of a 2009 Hotline complaint filed by a member of the audit team, alleging UKW abuses, may have been breached in violation of the IG Act.

These allegations triggered an in-depth inquiry. It was conducted through interviews with officials from the offices of the DoD CFO, DFAS, and IG, who had knowledge of these audits. These meetings were followed by exchanges of written questions and answers and continuing communications with whistleblowers. And finally, the staff completed a thorough review of the audit work papers, which were provided to Senator Grassley by OIG between July 2012 and February 2013. Those documents were evaluated with the help and guidance of CPA-qualified government auditors. During the course of the review, these experts determined that the collection of work papers provided by OIG was incomplete. For example, the final Quality Assurance Review (QAR) Summary Spreadsheet, which related to a key issue examined during the inquiry, was never provided to Senator Grassley. In its place, ██████████ substituted his own unofficial “analysis” of the QAR Summary Spreadsheet prepared *ex post facto*, which appeared to contain inaccurate information. In addition, the initials of preparers and reviewers were missing from some of the work papers, wiping out the audit trail on revisions. When questions were raised, some but not all missing papers were provided with the explanation that they “were unintentionally excluded” from the collection provided to Senator Grassley.<sup>3</sup> At the conclusion of this inquiry, an estimated 126 work papers were still missing. No explanation was ever provided.

### **3. Why Was This Audit So Important?**

The OIG failed to complete an audit of a critical component of former Secretary Leon Panetta’s push to bring the entire DoD into compliance with the CFO Act.<sup>4</sup> This remains a high-visibility legislative issue because DoD is the only federal agency that remains delinquent, receiving disclaimers of opinion or failing grades for the past 17 years. The department’s financial statements are simply un-auditable and unreliable. The books just don’t balance because the central accounting agency has lost control of the money at the transaction level. To address these issues, Congress mandated that the department be in compliance by 2017. The Secretary of Defense determined that this goal was a top priority and should be reached sooner, if possible.

DFAS was established in 1990 to perform financial services, like paying the bills, bookkeeping, and budgeting, but more importantly, to clean up DoD’s unending accounting mess. Today, it is the department’s flagship accounting agency and is the centerpiece of the Secretary’s readiness initiative. It should be asserting leadership in this arena but has failed to do so.

<sup>3</sup>OIG letter to Senator Grassley, 2/14/13;

<sup>4</sup>Secretary of Defense Directive, 10/13/11, to move the audit readiness deadline from 2017 mandated by Congress to 2014; Plan endorsed by Secretary Hagel in testimony before the SASC on April 17, 2013;

DFAS claims to have earned an unblemished string of 13 unqualified or “clean” opinions on its financial statements since FY 2000. Yet, when Senator Grassley’s staff looked at a snapshot in time, that is 2008-09, those opinions were found to be unsupported by sufficient evidence. For FY 2008, the OIG endorsed the opinion when the record suggested non-endorsement was justified. For FY 2009, the record indicated that OIG intended to non-endorse the opinion but failed to formally report it. In both cases, the record shows that UKW did not perform sufficient audit work to support clean opinions. Does this suggest the other clean opinions earned by DFAS were a sham? The alleged OIG cover-up also created a troubling credibility gap regarding the key element of the Secretary’s CFO audit initiative. So long as the credibility of the financial statements produced by the department’s central accounting agency remains in doubt, the viability of the entire audit readiness plan could be in jeopardy. If the department’s central accounting agency can’t earn a “clean” opinion, then who in the department can?

The Secretary of Defense and Congress deserve an answer to this simple question: are DFAS’ financial statements credible, yes or no? The primary reason DFAS slipped through the CFO audit net and was able to earn clean opinions was because the OIG failed to do its job. This breakdown of oversight had far-reaching and troublesome consequences and raises concerns about whether the integrity of the audit process may have been compromised.

#### **4. Flawed Contract Opened Door to Egregious Transgressions**

The audit contract is a good place to begin, because it set the stage for all that followed. If there were an opportunity to abuse the audit process, then the design of the contract is probably where it all began.

Prior to FY 2008, the financial statements produced by small organizations, like DFAS, were audited by CPA firms at the direction of the DoD CFO. The small Defense organizations would contract for the CPA services. The OIG neither used its limited resources to audit the financial statements of the small Defense organizations or to perform oversight of the opinions awarded by the CPA audit contractors. For large Defense organizations, like the Corps of Engineers, the OIG did perform oversight of the CPA audit contracts. Oversight was achieved through a mechanism known as the CFO “Master” or Multiple Award Contract. Consistent with the IG Act and DoD Instruction 7600.02 on Audit Policies, these contracts granted OIG pre-eminent oversight authority: 1) to review and approve invoices for payment; and 2) to determine whether the CPA firm’s opinion met government auditing standards. This structure positioned the OIG contract officer representatives (CORs) to make the final determination. If the firm’s opinion met prescribed standards, the OIG COR would issue an endorsement report. If not, a non-endorsement report would be issued.

In FY 2007, the DoD CFO requested that the OIG perform oversight of all the contract audits of the Defense organizations. The DFAS contract in question, which governed the audits of DFAS’ financial statements for FY 2008-09, contained all the key provisions of the “Master” contract with one major deviation.<sup>5</sup> At the insistence of the DoD CFO, a special DFAS contract was issued instead of the usual OIG “Master” contract. This special DFAS contract gave the DFAS Contracting Officer (CO) absolute control over the OIG CORs.

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<sup>5</sup> Contract No. GS-23F-9804H, 2/29/08;

The OIG attempted to maintain oversight authority and align the contract with the IG Act and audit policy by issuing a “waiver.” This was an ambiguous reservation. The waiver document stipulated that the OIG would act as the COR on the contract with authority to approve invoices for payment and make the endorsement decision.<sup>6</sup> Those key principles were reflected in the contract, and the Deputy DoD CFO and DFAS management agreed to those terms and conditions.<sup>7</sup> So the waiver should have protected OIG interests and allowed the OIG CORs to do their job without interference from the DFAS CO. Yet as one knowledgeable observer put, “the waiver gave DFAS the upper hand,”<sup>8</sup> and under pressure this fragile trust was quickly broken.

At least one senior official in the audit office, Assistant IG [REDACTED], had grave reservations about using a DFAS contract. In September 2007, he warned: “**I think this violates the IG Act and DoD Directive 7600.2.**”<sup>9</sup> The OIG Legal Counsel agreed. OIG General Counsel [REDACTED] was also highly critical of this arrangement. He suggested that the terms of contract “transferred” the OIG oversight function to DFAS, the very component whose financial data was subject to the oversight. In February 2010, [REDACTED] said that the contract terms will leave the OIG “open to criticism on the Hill . . . In two years some Senator will yell at us [for doing this] . . . . If I had known about the arrangement, I would have advised against it.”<sup>10</sup> [REDACTED] concerns were well-founded, and like a modern day Nostradamus, his prediction would soon come to pass.

Sure enough, when the OIG CORs determined that the CPA firm’s work did not measure up to standards and cut-off payments to the company in late 2009, DFAS pulled the “plug” on OIG oversight, starting on January 28, 2010. In the light of an impending non-endorsement report, DFAS sought to end OIG oversight and ignore the law, the contract, the waiver, and government audit standards. And the OIG let it happen without one recorded objection. OIG’s silence appeared to signal total acquiescence.

## **5. OIG Oversight of DFAS Audits**

Since FY 2000, DFAS has received 13 unqualified or “clean” opinions. Two were awarded by Deloitte and Touche, and the rest by UKW, which was purchased by Clifton Gunderson.<sup>11</sup> Of these 13 clean opinions, only two were examined in-depth by OIG, those for FY 2008 and FY 2009. Both opinions were rendered by UKW and both became embroiled in controversy. A third audit for FY 2010 was planned but cancelled after the 2009 non-endorsement fiasco.

The official OIG records of these audits, known as work papers, which were reviewed by Senate investigators with guidance provided by CPA-qualified government auditors, clearly indicate that DFAS should **not** have been awarded a clean opinion in FY 2009. The record for FY 2008, by comparison, is not so clear-cut. It is **murky and stained**. Both audits are the focus of this inquiry.

<sup>6</sup> [REDACTED] email to DoD CFO and [REDACTED], 10/4/07;

<sup>7</sup> Internal OIG Email to [REDACTED], 9/14/07;

<sup>8</sup> Whistleblower email, 12/19/12;

<sup>9</sup> [REDACTED] email, 9/14/07, to senior OIG management, including [REDACTED] and [REDACTED];

<sup>10</sup> Summary of Meeting with OIG General Counsel [REDACTED], 2/16/10;

<sup>11</sup> UKW sold their Federal audits practice to Clifton Gunderson; However, for the FYs 2008 and 2009 DFAS audits, Clifton Gunderson retained the UKW name;

The preparation of these financial statements and attendant audit work probably cost the taxpayers \$20 million dollars or more. If the audit work was unreliable, then this money may have been wasted. This was important work that needed to be done credibly and should have been finished with the publication of formal non-endorsement reports. But it was left unfinished and in limbo. These audits were inherently important because they examined a critical link in the Defense Secretary's audit readiness initiative. If DFAS is unable to accurately report its own internal "housekeeping" accounts of \$1.5 billion, then there are grave concerns about DFAS's ability to accurately report on the hundreds of billions DoD spends each year.

#### **A. UKW's 2008 Opinion Got a Pass**

Although UKW's "clean" opinion on DFAS's FY 2008 statements was officially validated and endorsed by the OIG, the audit's findings were far from conclusive.

According to whistleblowers and the work papers, the OIG audit team appeared most concerned about the adequacy of internal controls over financial statement **compilation procedures**. Compilation is the process by which account balances are transferred from a vast number of individual accounting records to the financial statements or to correct accounting records using journal vouchers (JV) adjustments. The OIG audit team determined that UKW had failed to adequately document and test internal controls over JV adjustments as required by professional standards.<sup>12</sup> DFAS had made some \$4.4 billion in JV adjustments that were not adequately supported in accordance with the DoD Financial Management Regulation, volume 6A, chapter 2 and therefore did not appear to be auditable. Adequately supported JVs is essential to provide audit trails or detailed source documentation that auditors need to audit JV adjustments. Clearly, such widespread use of unsupported "plug" figures for an organization with only \$1.5 billion in budgetary resources was a red flag.

From day one, the compilation issue has been a major material internal control weakness on the DoD-wide financial statements. The same standard should have been applied to DFAS' statements. Those internal control deficiencies should have been characterized as being material weaknesses. Unfortunately, they were not. OIG senior management would not allow it, according to whistleblowers. Instead, Deputy ██████ instructed the audit team to downgrade this internal control problem. She directed them to improperly report unsupported compilation adjustments caused by poor internal controls as being **not** a material weakness.<sup>13</sup> According to a whistleblower with first-hand knowledge, this order was "incomprehensible because the \$4.4 billion in JV adjustments were close to 3 times larger than the \$1.5 billion budgetary resources DFAS was reporting in its financial statements. This was a material internal control deficiency, and we were prevented from reporting it as such."<sup>14</sup> U.S. Office of Management and Budget (OMB) rules required UKW to report all significant internal control deficiencies in its published audit reports.<sup>15</sup> However, UKW, allegedly with OIG management's tacit approval, failed to report the significant internal control deficiencies in its audit report as required by OMB rules.

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<sup>12</sup>American Institute of Certified Public Accountants (AICPA) Audit Section of the AICPA Professional Standards (AU) Section 316, Consideration of Fraud in a Financial Statement, Paragraphs .58 through .62;

<sup>13</sup> ██████ email to ██████ and ██████ on Draft DFAS Internal Control Memo, 3/20/09, with ██████ comments;

<sup>14</sup> Whistleblower email, 4/1/13;

<sup>15</sup> OMB Bulletin No. 07-04, Audit Requirements for Federal Financial Statements;

The OIG audit team was also faced with the refusal of UKW personnel to discuss prior year audit test results and error adjustments. The OIG auditors reviewed UKW's working papers underlying its opinion on the FY 2007 DFAS financial statements and determined that UKW had reduced year-end testing sample sizes despite the fact that mid-year test results showed very high error rates. In accordance with auditing standards, OIG auditors sought an explanation of why UKW would reduce the amount of substantive audit testing at year-end in the face of the high risk levels UKW documented through mid-year test results.<sup>16</sup> Auditors should consider prior year misstatements, errors, and adjustments in evaluating current period errors and risk of material misstatement.<sup>17</sup> Instead of complying with the requests and following accepted practices, according to whistleblowers, UKW personnel ignored these requests and bypassed the OIG COR's authority by seeking relief from OIG senior managers, mainly Assistant IG [REDACTED] and Deputy Assistant IG [REDACTED]. In response to this pressure, they allegedly supported the firm's complaint, effectively blocking the request for relevant information and preventing the audit team from performing essential review procedures on prior year test results and error adjustments. **A critical scope limitation was thereby created that could have easily resulted in OIG's non-endorsement of UKW's unqualified opinion.**<sup>18</sup> The firm's refusal to provide explanations for questioned audit data could also be viewed as a hindrance to the successful conclusion of this audit. The actions taken by OIG senior management violated both the Generally Accepted Government Auditing Standards (GAGAS) on Ethics, Chapter 2, and Independence and Impairments, Chapter 3.

Because of all these discrepancies, the audit team repeatedly informed OIG management and UKW in late 2008 that the firm's opinion should not be endorsed.<sup>19</sup> A big reason for that assessment was the lack of credible work on the compilation process. The OIG audit team supervisor, [REDACTED], informed [REDACTED] that compilation was a show-stopper. [REDACTED] reportedly told him to "pound sand," or words to that effect, and directed him "to do whatever was needed" to resolve the compilation issue.<sup>20</sup> More work was done, but the results were the same. When the additional work failed to produce the desired results, [REDACTED] allegedly "ordered" the audit team to produce an endorsement report."<sup>21</sup> Although that allegation came from several reliable sources, Senate investigators could not independently corroborate the claim with work paper documentation.

On December 22, 2008, OIG formally endorsed UKW's unqualified opinion. UKW, for its part, promised to address the compilation issues during the FY 2009 opinion process. If DFAS failed to correct these deficiencies, **"there was an increased risk of material misstatements in future DFAS financial statements."**<sup>22</sup>

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<sup>16</sup>AICPA AU Section 350, Audit Sampling, Paragraph .43 and .44;

<sup>17</sup>AICPA AU Section 314.127.C1, Appendix C, Conditions and Events that may indicate Risks of Material Misstatement; In addition, AICPA AU Section 339, Audit Documentation, paragraphs 339.08, 339.36.A1.e; 339.36.A1.g;

<sup>18</sup>AICPA AU Section 333, Management Representation, Paragraph .14;

<sup>19</sup> Emails between [REDACTED], [REDACTED], and [REDACTED], including 11/8/08, 11/14/08, 11/19/08 and 11/20/08;

<sup>20</sup> Whistleblower emails, 3/13/13 and 3/29/13;

<sup>21</sup> Whistleblower email, 5/24/12; [REDACTED] order was allegedly made by telephone to the OIG COR, [REDACTED];

<sup>22</sup> Reference to deficiencies detected during review of 2008 opinion as presented in Decision Memo on Non-Endorsement on FY 2009 Statements, dated 2/16/10;

While these words appeared in the Decision Memo on the FY 2009 opinion, their foundation is the FY 2008 review. They constituted a clear, unambiguous warning about future endorsements: either fix the problem or face non-endorsement. But it was not fixed. Instead, the very same issues, along with other more troublesome ones, re-surfaced and spilled over into OIG's next oversight review. For FY 2008, it is possible DFAS and UKW received a "pass," but given the warnings about the compilation issue, dark clouds appeared on the horizon.

## **B. Hotline Complaint Ignored, Compromised, and Possibly Destroyed**

As discussed in the section above, the CPA firm, UKW, allegedly interfered with and may have stood in the way of effective oversight by the audit team during the 2008 review by refusing to grant legitimate requests for access to relevant and essential audit data. What is more troublesome, however, is the allegation that OIG senior management appeared to condone and support this alleged misconduct by backing up the firm's abusive tactics. This alleged scenario created a hostile working environment, which, in turn, led to a formal complaint being filed with the OIG Hotline.

On May 1, 2009, a member of the OIG audit team communicated with the Hotline regarding the quality of work performed by UKW and the abusive manner with which the firm's "engagement partner" or designated representative treated OIG audit staff.<sup>23</sup> The UKW employee involved is named in the email. The complaint alleged that UKW's engagement partner was "attempting to intimidate" him for being critical of the firm's "substandard work products."<sup>24</sup> His conduct was "abusive," and he attempted "to impair the independence of the audit process." As an example of alleged interference, the whistleblower involved cites the mishandling of a request for access to relevant work paper documentation. The company by-passed the audit team and went straight to OIG senior management for approval to withhold it.<sup>25</sup> This inappropriate move effectively blocked the team's access to essential documents.

In a letter dated May 16, 2012, Senator Grassley asked Acting IG Halbrooks what action was taken to address and resolve this Hotline complaint. In a response dated June 26, 2012, the OIG reported that the Hotline "does not have any record" of this complaint. Although the whistleblower provided Senator Grassley with a copy of the complaint transmitted to the Hotline electronically, as far as the Hotline is concerned, it simply does not exist and never did. This raises several questions: Does the Hotline have some computer defect that fails to record complaints? Was there a human error in failing to record the complaint? Or, is there an effort to prevent Senate investigators from obtaining records?

Two top-level managers in the Audit Office, Principal Assistant IG [REDACTED] and Assistant IG [REDACTED], were reportedly aware of this Hotline complaint at the time it was filed and knew the identity of the complainant. Using his or her name, [REDACTED] reportedly informed a supervisor that "she had been told that this person had made a Hotline call." [REDACTED] allegedly dismissed this complaint as nothing more than "a crank call."<sup>26</sup>

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<sup>23</sup> Email to Hotline; Subject: Complaint Against Contractor, 5/1/09;

<sup>24</sup> Email from whistleblower, 6/26/12, including complaint to the Hotline;

<sup>25</sup> Whistleblower email, 4/14/13

<sup>26</sup> Whistleblower email, 6/28/12;

Since the auditor's Hotline complaint was a protected communication, the Hotline was required by law to safeguard the **confidentiality** of the complainant's identity. The disclosure of the whistleblower's identity by the Hotline to that person's supervisors, without his or her consent, would be a breach of confidentiality and the sacred trust between OIG and whistleblowers, who step forward at great personal risk. Such a disclosure would violate Section 7 of the IG Act.

### **C. FY 2009 Non-Endorsement Decision**

In late 2009, once the OIG determined that the CPA firm's audit opinion did not meet prescribed standards, the non-endorsement process was set in motion. The OIG COR instructed DFAS to stop payments on five outstanding UKW invoices valued at \$148,669.00. The OIG legal counsel "recommended that those invoices not be paid."<sup>27</sup> Those decisions precipitated a classic bureaucratic impasse.

The impasse came to a head at the DFAS Audit Committee meeting held on January 27, 2010, where three options were considered: 1) The IG would issue a non-endorsement report; 2) The CPA firm would do more work on accounts payable and undelivered orders issues; and 3) The IG would do additional work to support an audit opinion. The very next day, January 28<sup>th</sup>, a senior official, Assistant IG [REDACTED], announced the results of the meeting. [REDACTED] **reported that a consensus was reached: No additional work would be performed and declared that the OIG would issue a non-endorsement report.**<sup>28</sup> First, Assistant IG [REDACTED] would not have made that announcement unless she had sufficient appropriate evidence to non-endorse the opinion and issue the report. Secondly, she would not have done that without the approval of top-level management, including [REDACTED].<sup>29</sup> The record clearly shows that [REDACTED], at least initially, understood and accepted the non-endorsement decision.<sup>30</sup>

The consensus announced by AIG [REDACTED] was between the three main targets of the audit: 1) DFAS; 2) the CPA firm; and 3) the DoD CFO, who supervises the central accounting agency. They probably shared a common goal: Stop the audit work. Overturn the non-endorsement decision. These are predictable responses from audit targets, especially if there were other problems to be discovered. But why did OIG simply fold and accept DFAS' decision to disallow further audit work without following through on its decision to issue the non-endorsement report? Why not work the audit trail until all options were exhausted? Was something being covered-up? Was it knowledge that doing more audit work would have been futile because DFAS' financial statements were in such bad shape they could never pass the test? Was this part of a concerted effort to let some insignificant amount of unfinished work be used as a false pretense for blocking publication of the report or allowing it to undermine the report's credibility? In response to Senator Grassley's questions, [REDACTED] attempted to use unfinished work as an excuse for quashing the report, but there is not one shred of evidence to back-up that assertion.

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<sup>27</sup> Summary of meeting with OIG General Counsel, 2/16/10;

<sup>28</sup> [REDACTED] email, dated 1/29/10, to [REDACTED], UKW, and DFAS;

<sup>29</sup> Emails from [REDACTED] to [REDACTED] and other OIG audit officials, 1/28/10;

<sup>30</sup> Email from [REDACTED] to [REDACTED] and [REDACTED] 1/26/10 and 1/27/10 ;

The official record of this audit, as portrayed in the work papers, clearly shows that all the work necessary for publishing the non-endorsement report was, in fact, done. No additional audit work was required for that purpose. The decision to non-endorse the UKW opinion had been made. The formal documents reflecting those decisions were prepared and signed several weeks after [REDACTED] announcement.

#### **D. Non-Endorsement Decision Memo**

The Decision Memo, dated February 16, 2010, presented compelling evidence, and all of it pointed in just one direction: to non-endorsement.<sup>31</sup> The IG's audit team and its Quantitative Methods and Analysis Division (QMAD)<sup>32</sup> reported three major material deficiencies in the CPA firm's work. These were cited in the final Decision Memo as follows:

- Unacceptable statistical sampling methods and sample sizes for UKW's testing of accounts payable and undelivered orders;
- UKW did not provide sufficient evidence that it adequately reviewed the compilation process used in DFAS' financial statements;
- UKW did not prepare a required memorandum that summarized the audit results and demonstrated the adequacy of the audit procedures, appropriateness and sufficiency of the audit evidence, and the reasonableness of its conclusions.

All UKW evidential deficiencies were considered in arriving at the non-endorsement decision, including compilation and statistical sampling issues.<sup>33</sup> As [REDACTED] stated, "the compilation issue is **material**."<sup>34</sup> The other key piece of audit evidence pertained to statistical sampling issues. That analysis was provided by the QMAD and, being highly technical in nature, was documented by OIG's expert statisticians and presented in reports contained in the work papers that are reflected in the Decision Memo.<sup>35</sup> Another factor influenced the non-endorsement decision. UKW had failed to disclose significant, material internal control deficiencies, especially in the compilation process, in a published report as required by applicable audit standards. Justification for this omission was requested but never provided. OIG senior management turned a blind eye despite protests from the audit team, a fact confirmed in the work papers.<sup>36</sup>

These three deficiencies were the bottom-line for OIG's assessment: "**The OIG cannot endorse UKW's unqualified opinion because, in our professional judgment, there was not sufficient audit evidence to support an unqualified audit opinion and, the working papers did not provide sufficient information for us to reach the same conclusion.**"<sup>37</sup>

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<sup>31</sup>Decision Memo on Non-Endorsement of UKS's opinion on FY 2009 statements, dated 2/16/10 and draft Non-Endorsement letter to OIG senior management, email dated 2/16/10

<sup>32</sup>QMAD Memo to OIG, dated 2/26/10, entitled "Quantitative Issues with DFAS Working Capital audit performed by UKW/Clifton Gunderson, LLP;

<sup>33</sup> Email from [REDACTED] to [REDACTED] and [REDACTED], 2/5/10;

<sup>34</sup> Email from [REDACTED] to [REDACTED] and [REDACTED], 1/28/10;

<sup>35</sup> QMAD Memo from [REDACTED] and [REDACTED] to [REDACTED], 2/26/10

<sup>36</sup> Whistleblower email, 4/10/13;

<sup>37</sup>Decision Memo, 2/16/10, pp. 2-3;

The “Decision Memo” constituted the justification and authorization for issuing the non-endorsement report. This document was signed by the GS-15 audit supervisor, [REDACTED], and approved by higher management. No additional work was required to support the three main points cited above.<sup>38</sup> On February 16, 2010, the same day the Decision Memo was signed, an email forwarded the final version of the non-endorsement report to senior management. The email was from [REDACTED]. It reads as follows: “Attached is the non-endorsement letter. I think we have made your changes. Let us know when we can send it to edit.”<sup>39</sup> This was the revised draft report that included senior management’s recommended changes.<sup>40</sup> The letter was, in fact, the final version of the non-endorsement report. It was addressed to the DoD CFO and DFAS Director with a copy to the CPA firm. It contained the rationale for the auditor’s opinion. It was ready to go. It was finalized but never signed. The report was never issued and the letter never sent. Instead it was buried in the work papers far from public view. Who did it and why?

### **E. Who Quashed The Report?**

A Memorandum for the Record pertaining to a meeting on March 11, 2010, sheds light on who killed the report.

This memorandum states: “[REDACTED] and [REDACTED] have agreed that there will be no written closing memo or report to DFAS . . . . The verbal report that [REDACTED] provided to the DFAS Audit Committee of January 27, 2010, will be our formal report.”<sup>41</sup> Well, [REDACTED] verbal report was, in fact, the official OIG announcement of the decision to issue the non-endorsement report. She made that decision based on the rock solid evidence presented in the Decision Memo and did so with the approval of top-level management, including [REDACTED].<sup>42</sup>

About a month later, [REDACTED] informed DFAS **by telephone** that OIG would not issue the non-endorsement report.<sup>43</sup>

So what caused their sudden and unexplained turnaround? Since the abrupt reversal on publishing the report is not explained or documented in the work papers, it is not unreasonable to assume that decision originated at a higher level. Did [REDACTED] merely acquiesce under pressure from [REDACTED] to quash the report? At the time, [REDACTED] had just been promoted to Principal Assistant IG for Auditing. That made him the top OIG official directly involved in this matter. [REDACTED] was his subordinate. He should be accountable for this decision.

### **F. Explanations for Suppressing Report**

As for the official reasoning behind the decision to quash the report, there appears to be none. Neither the March 12, 2010, memo cited above nor any of the work papers provided to Senator Grassley offers a clue as to why OIG decided to bury this report.

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<sup>38</sup>Whistleblower email, 2/28/13;

<sup>39</sup>Email from [REDACTED] to [REDACTED] and others, dated 2/16/10;

<sup>40</sup>Email from [REDACTED] to [REDACTED], 2/12/10;

<sup>41</sup>Memo for the Record, 3/12/10, on meeting with [REDACTED] Deputy, [REDACTED];

<sup>42</sup> Emails from [REDACTED] to [REDACTED] and other OIG audit officials, 1/28/10;

<sup>43</sup>Email from [REDACTED] to [REDACTED] and [REDACTED], 4/13/10;

The reasoning offered by OIG after-the-fact in response to Senator Grassley's questions does not seem plausible. ██████ has consistently argued that issuing the non-endorsement report was unnecessary. Doing the additional work to finish the job would have been a waste of precious audit resources, in his opinion. In making these assertions, ██████ appears to undermine his own arguments as illustrated in the three-point rebuttal below:

**First**, as the Deputy IG for Audit, ██████ should know that the OIG, as a Co- Principal Auditor, was **required** to issue that non-endorsement report, consistent with auditing standards specified in the contract and the Financial Audit Manual.<sup>44</sup> The verbal non-endorsement did not get attached to the DFAS financial statements or the audit opinion. The verbal non-endorsement failed to meet the standards for reporting the audit results to the user, Congress, or the public. Nor did the verbal report meet the standards for financial reporting contained in GAGAS.<sup>45</sup> And, the record clearly demonstrates that it was totally ineffective.

**Second**, failing to issue the report was inconsistent with OIG "SOP." OIG audits are rarely, if ever, "closed out" with verbal reports. ██████ verbal report was the most effective way to communicate non-endorsement, then why does DFAS continue to ignore OIG's "verbal report" and claim to have earned a clean opinion. And why does ██████ continue to endorse DFAS' clean opinion, because that makes the case for publishing non-endorsement reports.<sup>46</sup> If non-endorsement reports are as wasteful as ██████ would have us believe, then why has the OIG expended precious audit resources to issue hard-hitting non-endorsements to smaller, less important agencies like the Defense Information and Threat Reduction Agencies? Why did OIG go to considerable effort to overturn the Defense Information Agency's (DISA) clean opinion for FY 2011.<sup>47</sup> In the very recent DISA case, the OIG determined that the outside audit firm, Acuity Consulting, "did not have sufficient evidence to issue an unqualified opinion," and recommended that Acuity "withdraw their opinion." Or why would the OIG reportedly invest in excess of 47,000 man-hours in auditing DISA's FY 2008 financial statements?<sup>48</sup> The OIG has a well-documented track record for doing this kind of audit work and publishing the results, and ██████ should know it.

**Third**, ██████ also suggests that he blocked the report because the work papers were not up to standards. The merits of this assertion rest on the authenticity and accuracy of his so-called "analysis" of the Quality Assurance Review (QAR) quality review of the audit that was conducted between February and March 2010.

██████ is correct in saying that work paper deficiencies existed, but certainly not the 210 "critical" deficiencies cited in a letter to Senator Grassley.<sup>49</sup> The 210 critical deficiencies were based on an unofficial "analysis" of the QAR Summary Spreadsheet created by ██████ *ex post facto*. ██████ provided handwritten comments to a partially completed QAR Summary Spreadsheet in response to Senator Grassley's numerous inquiries.

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<sup>44</sup> GAO/PCIE Financial Audit Manual (FAM), Sections 510.01, 580.01 and 650.09.d, and 650.19;

<sup>45</sup> Government Audit Standards, July 2007 Revision, Reporting Standards for Financial Audits, Chapter 5, pages 78-88.

<sup>46</sup> OIG letter to Senator Grassley, 1/31/13, enclosure. P. 3;

<sup>47</sup> DoD OIG Audit Report 2013-071, April 26, 2013;

<sup>48</sup> Whistleblower emails, 11/13/12 and 4/12/13;

<sup>49</sup> OIG letter to Senator Grassley, 1/31/13, page 1 of enclosure.

Despite his assurance to the contrary, this document was not the official “QAR Summary” that had been “inadvertently” and “unintentionally excluded” from the collection of work papers promised to Senator Grassley, along with other “missing files.”<sup>50</sup> It was not a genuine work paper. ██████ “analysis” was incomplete and inaccurate. It did not contain the audit team’s responses to the QAR questions. It did not contain the initials of the persons who prepared and reviewed it nor their preparation and review dates. The audit trail on revisions was missing. This document was not part of the work papers, and it appears to be inaccurate and unsupported by evidence in the work papers.

The final, official QAR Summary Spreadsheet, which was provided to Senator Grassley by other sources, presents a very different picture. It shows only minor issues. That fact is clearly and unambiguously validated in an email that transmitted the “actual QAR schedule” or “summary of improvements the audit team made to the working papers.”<sup>51</sup> The OIG audit team re-reviewed all of the actual 96 QAR comments (238 less 142 without comments). Fifty of those were found to be in error or contained errors. There was, indeed, a need to “tidy up” the work papers to address QAR comments. However, ██████ assertion that “all” work paper comments had to be addressed before the report could be issued is alleged to be patently false based on applicable audit standards.<sup>52</sup>

There is nothing in the work papers that justified the need to delay issuing the report beyond February 16, 2010, when the Decision Memorandum was signed.<sup>53</sup> All the audit work necessary for publishing the non-endorsement report had been completed, reviewed, and accepted in accordance with applicable auditing standards.<sup>54</sup> The normal work paper “tidy-up” process could have been performed after the report was issued. Under AICPA rules, a report can be issued when the work papers are not 100 percent completed so long as the audit team has agreed to the sufficiency and appropriateness of the audit evidence, which was, in fact, the case.<sup>55</sup> None of the QAR comments mitigated or negated the sufficiency or appropriateness of the audit evidence supporting the non-endorsement decision. While whistleblowers allege that the QAR was not conducted in accordance with OIG audit policy and may have been an attempt to discredit the non-endorsement decision and conceal audit findings,<sup>56</sup> the official QAR only confirmed and reinforced the non-endorsement decision. ██████ assertions notwithstanding, there were no QAR or work paper “show-stoppers.”

In short, ██████ excuses for suppressing the non-endorsement report do not stand up to scrutiny. There is no evidence in the work papers to back-up his decision. There is not one shred of evidence in the work papers that runs counter to the decision to non-endorse the UKW opinion. ██████ had a reason for killing the report, and it had nothing to do with the validity of audit evidence. So what was that reason?

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<sup>50</sup> OIG letter to Senator Grassley, 2/14/13 and email, 2/15/13;

<sup>51</sup> Email from ██████ to ██████ and ██████, 5/27/10;

<sup>52</sup> DIG Halbrooks letter to Senator Grassley, 11/15/12, Enclosure;

<sup>53</sup> Delaying publication could have generated a need to do more audit work to review any developments after the conclusion of fieldwork, AICPA, AU 339, “Audit Documentation,” paragraph .23;

<sup>54</sup> AICPA, AU 339, Audit Documentation, Paragraphes .23, .27, .28;

<sup>55</sup> AICPA, AU 339, Audit Documentation, Paragraph .27

<sup>56</sup> Letter to Senator Grassley, 1/31/13, ██████ enclosure, p. 3; Whistleblowers allege that this QAR did not meet requirements specified in the Audit Handbook, email, 2/28/13;

## **G. Halbrooks Sidesteps [REDACTED] Explanations**

In a letter to Senator Grassley, Deputy IG Lynne Halbrooks appeared to dodge [REDACTED] explanations for suppressing the report. Instead, she seemed to concur with the central premise of this inquiry, that is, UKW's opinion failed to meet prescribed audit standards and the non-endorsement report should have been issued.

Deputy IG Halbrooks stated that "it was the intent of the Assistant IG for Defense Business Operations [REDACTED] to issue a formal letter of non-endorsement of the audit opinion provided by UKW on the DFAS 2009 Financial Statements, even though it is not required by audit standards or the contract .... In hindsight," she said, "it would have been beneficial if the DoD IG could have completed the work necessary to support a non-endorsement letter. Given the same circumstances today, the DoD IG would do things differently."<sup>57</sup> In closing, she underscored the importance of this work within the context of Defense Secretary's audit readiness goals.

## **H. Speculation About What Happened**

Whistleblowers reject [REDACTED] explanation as disingenuous. They offer two explanations for why the report was quashed: 1) To spare the DoD CFO another black-eye for "unending DFAS accounting screw-ups;" and 2) CFO Hale and [REDACTED] "cut a deal" to halt impending OIG budget cuts in exchange for a commitment to sit on the non-endorsement report. [REDACTED], [REDACTED] and Hale met regarding "a 10 percent reduction the DoD CFO was planning to impose," but there is no hard evidence of any kind of quid pro quo.<sup>58</sup>

## **6. DFAS Bypassed OIG Oversight**

DFAS' blatant end-run maneuver described below was possible because of the escape clause embedded in the contract discussed earlier in the report. After OIG declared its intention to issue the non-endorsement report, DFAS took aggressive action to circumvent oversight.

In what appears to be overt defiance of the OIG's non-endorsement decision, the agency's Director of Resource Management, [REDACTED], in a letter to UKW, unilaterally declared that her agency had "**proudly achieved an unqualified opinion.**" [REDACTED] letter was dated February 19, 2010. At that juncture, this opinion had been explicitly rejected by the OIG. The Decision Memo had been signed on February 16<sup>th</sup>, and the non-endorsement report was awaiting final signature. [REDACTED] knew it based on Assistant IG [REDACTED] verbal report at the DFAS Committee meeting on January 27<sup>th</sup> and other communications.

The invoices approved for payment by [REDACTED] were the very same ones previously rejected by the OIG's COR, which was, in turn, based on advice from the IG's Legal Counsel, [REDACTED], who "recommended that the invoices not be paid."<sup>59</sup>

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<sup>57</sup>Halbrooks letter to Senator Grassley, 11/15/12 with enclosure;

<sup>58</sup>Whistleblower email, 1/21/13 and 1/23/13;

<sup>59</sup>Memo for the Record, meeting with OIG General Counsel, 2/16/10;

## **I. Potential Indicators of Fraud**

Selected work paper summaries highlight the gravity of [REDACTED] actions:

- DFAS knew that OIG would not endorse the UKW opinion because UKW did not provide sufficient audit evidence to support an unqualified opinion;<sup>60</sup> Yet, despite having this knowledge, which was acquired from [REDACTED] verbal non-endorsement announcement at the DFAS Audit Committee meeting on January 27, 2010, and through other communications, DFAS instructed UKW to issue the statements and opinion without OIG approval in violation of the terms of the contract and waiver;<sup>61</sup>
- DFAS “bypassed” the OIG COR and paid UKW without the COR’s approval;<sup>62</sup>
- DFAS “certified” and made “improper” payments against invoices rejected by the OIG COR based on advice from the OIG legal counsel;<sup>63</sup>
- An OIG project director discussed the “improper” payments with Assistant IG [REDACTED], but **“she elected not to formally report”** them;<sup>64</sup>
- Since UKW’s opinion did not meet audit standards and contract requirements, UKW had submitted bills for payment for work not performed “using the wire;”<sup>65</sup>

Even though OIG senior management was well aware of these highly questionable actions, their silent acquiescence and failure to call for corrective action as required by the IG Act and other laws is disturbing and raises questions about their competence and/or complicity.

### **OIG “Kicked” Off Contract**

Then on April 15, 2010, just a few days after the OIG announced that the non-endorsement report was dead, DFAS made its boldest move yet. The agency’s contracting officer, [REDACTED], effectively eliminated independent oversight by the OIG. He issued letters terminating the two OIG CORs.<sup>66</sup> [REDACTED] termination order was retroactive to January 27, 2010, the very same day the OIG officially announced its intention to issue a non-endorsement report. [REDACTED] apparently thought he had super-human powers and could reach back in time and wipe the non-endorsement report clean off the slate, as if it had never happened. The retroactive termination notices appear to be an amateurish and futile attempt to expunge the report from the public record and to legitimize and cover-up DFAS’s improper actions between January and April 2010.

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<sup>60</sup>OIG Work Papers, Project D2009-D000FL-0127.000 -- C.1.10; pg 11/21; Sec. 3.19.a.2;

<sup>61</sup>OIG Work Papers, Project D2009-D000FL-0127.000 -- C.1.PS.10, PP. 21-22;

<sup>62</sup>Same document as above and summary of meeting with OIG General Counsel 2/16/10;

<sup>63</sup>There were 5 disputed invoices valued at \$148,669.00;

<sup>64</sup>OIG Work Papers, Project D2009-D000FL-0127.000 -- C.1.17; pg.8; and C.1.16;

<sup>65</sup>OIG Work Papers, email, 2/13/10; Whistleblower email, 7/17/12;

<sup>66</sup>Letters to OIG CORs [REDACTED] and [REDACTED], dated 4/15/10;

As one whistleblower put it, “DFAS virtually kicked us, the Inspector General, out of the contract” . . . without as much as a peep from OIG.”<sup>67</sup> There may be a very good reason for OIG’s muffled response. According to a DFAS memo to Senator Grassley, [REDACTED] roundabout bureaucratic maneuver was allegedly requested and authorized by OIG officials.<sup>68</sup> In that memo, DFAS reported that the OIG COR, [REDACTED], requested the retroactive terminations and reportedly did it over the telephone. However, there is a dispute about who ordered the retroactive terminations.

In an attempt to resolve the dispute, OIG launched an investigation. Its outcome was inconclusive. Conflicting results were provided to Senator Grassley on April 4, 2013.<sup>69</sup>

According to the report provided to Senator Grassley, [REDACTED] denies that he ever made such a request but admits he discussed the effective date of the termination notices with [REDACTED], who allegedly told him flat-out that the notices would be back-dated to January 27, 2010. The back-dating was necessary, he reportedly said, “to reflect the period of performance of work done by the OIG audit team,” a statement that does not square with the facts. It is out of sync with the contract start date of February 2, 2008. That is when the COR’s work actually began, which was more than two years before they were fired. A senior DFAS official offered yet another explanation for this action that was equally problematic. She suggested that it was a necessary “administrative” measure, because the OIG would have no oversight authority for the FY 2010 audit. However, the 2010 contract modification, which was signed on March 30, 2010, had already removed the OIG oversight clauses from the contract.<sup>70</sup> So neither explanation makes sense.

Instead of challenging the retroactive terminations and defending the integrity and independence of the audit oversight process, [REDACTED] testimony suggests he simply rolled over and kept his mouth shut, telling essentially no one about getting “kicked” off the contract. He seems to have had the mistaken notion that he was “serving at the will” of the DFAS contracting officer. The special waiver arrangement, which is discussed earlier in this report, was designed to ensure that the COR’s remained totally independent of the DFAS contract officer. [REDACTED] silence, in turn, has allowed OIG’s senior management to claim that they were kept in total darkness and unaware of the firings. Senior OIG management officials, including Deputy IG [REDACTED], Deputy [REDACTED], and former Assistant IG [REDACTED], now claim that they “were unaware of the retroactive terminations of the COR’s at the time of the event.” [REDACTED] goes even further. He stated that he did not know about the firings until June or July of 2012, when Senator Grassley started asking questions about what happened.

The seemingly implausible account offered by OIG, which is presented in the April 4<sup>th</sup> letter to Senator Grassley, deserves closer scrutiny. It needs to be put in the proper context.

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<sup>67</sup> [REDACTED] email to OIG officials, dated 3/22/10;

<sup>68</sup> DFAS Memo to Senator Grassley, transmitted by email, dated 9/11/12, pp. 5-6;

<sup>69</sup> OIG letter to Senator Grassley, dated 4/4/13 with [REDACTED] enclosure;

<sup>70</sup> Meeting with [REDACTED], Deputy Director, DFAS Columbus Center, 8/3/12;

The targets of the retroactive terminations were the two OIG contract representatives. They were chiefly responsible for preparing the audit that led to the decision to issue the non-endorsement report on UKW's opinion and stopping payments to that firm. Almost immediately after the non-endorsement decision was announced, DFAS began taking aggressive steps to undo that decision. The firings were a logical extension of the end-run maneuver that was set in motion immediately following the non-endorsement decision. That decision was the root cause problem in DFAS' eyes that had to be erased from the audit map. At this critical moment, all the parties involved, the DoD CFO, OIG and DFAS, were actively engaged in high-level negotiations on how to deal with the non-endorsement decision. Emails were flying back and forth. Under these circumstances, it seems incomprehensible that ██████████ would not have informed senior management that OIG had been kicked off the contract. The record clearly shows that ██████████, ██████████, and ██████████ were intimately involved in every aspect of this audit. How is it that the retroactive firings did not reach them as soon as they happened or even sooner? How is it that ██████████ could excise the OIG from this oversight contract without their approval?

While we may never know the truth about the retroactive firings, there is one very revealing piece of information that helps to shed light on the most likely answer, and that is OIG's muted response to these disgraceful events. Not one word of concern has been uttered by the OIG, at any level, from the time the retroactive terminations occurred right up to the present time. The firings allegedly constituted a blatant violation of the contract, the special waiver, and the IG Act. They amounted to a frontal assault on OIG oversight authority. Yet not a word of criticism came from OIG. Not one question was raised. Other than the Hotline complaint that disappeared down a black hole, no protest was ever lodged. No corrective action was ever proposed or taken. Once again, OIG's silence could signal acquiescence. **Silent acquiescence seems to have been the OIG modus operandi in this matter.**

## **7. General Findings and Conclusions**<sup>71</sup>

Two misguided acts set the stage for the collapse of oversight with this audit.

The problem began with the contract.

At the insistence of the DoD CFO and DFAS, the OIG agreed to a contractual arrangement that transferred its independent audit authority to DFAS, the target of the audit. This contract allegedly violated the IG Act and standing audit policy. For this reason, a fragile waiver arrangement was put in place. It was supposed to address the legal issue and to protect OIG interests under the DFAS contract, but this informal trust was violated by DFAS with OIG's silent acquiescence.<sup>72</sup> When the OIG auditors produced a very unfavorable report on UKW's opinion on DFAS's financial statements, the current Deputy IG for Audit, ██████████, drove the final nail into the audit's coffin. He quashed that report and allegedly assured DFAS that it would never see the light of day. From that point forward, DFAS thought it had the green light to bypass oversight with impunity.

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<sup>71</sup> Unresolved issues flowing from this oversight investigation have been referred to Integrity Committee of the Council of the Inspectors General on Integrity and Efficiency for further review and resolution in accordance with its authority and responsibilities under the Inspector General Reform Act of 2008;

<sup>72</sup>The waiver is described on page 5 of the report;

This questionable contractual arrangement coupled with the decision to quash the report, when taken together, opened the door to a series of ethical and legal blunders.

The work performed by DFAS was sub-standard. The outside audit firm rubber stamped DFAS' practices using defective audit methods. This firm may have been paid for work that was not performed. Those payments were alleged to be "improper." For its part, the IG was prepared to call foul on UKW for sub-standard work but was steamrolled by DFAS, which was allowed to run rough shod over the contract, the IG Act, audit standards, and independent oversight. Instead of exposing poor practices by both DFAS and UKW, the OIG allowed those sacred principles to be trampled. It kept quiet, turned a blind eye to what was happening, and tried to cover its tracks.

In addition to the principles and standards that were trampled during the course of these two audits, all the bungling portrayed in this report could have two other profound, long-term consequences, repercussions that could be harmful and wasteful.

First, compelling audit evidence, which undermined the credibility of the financial statements prepared by the department's flagship accounting agency, was shielded from public disclosure. Moreover, the existence of such unreliable financial information has the potential for putting the Secretary of Defense's audit readiness initiative in jeopardy. 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 cannot earn a "clean" opinion, then who in the department can?

Second, the integrity and independence of the OIG audit process may have been compromised. If the independence of the audit process was, in fact, compromised as the facts in this report appear to suggest, then the department's primary tool for rooting out waste and fraud could be disabled. And if that has, indeed happened, then it probably happened with the knowledge and silent acquiescence of the OIG, the institution that exists to root out fraud, waste and abuse. In simple terms, the watchdog who was appointed to expose and stop fraud and waste have been doing it. If true, it clearly demonstrates a lack of commitment on the part of senior management to exercise due professional care in performing its core mission.<sup>73</sup> Clearly the OIG did not act alone. This was a concerted effort. Others were involved, but senior OIG officials must bear primary responsibility for this unacceptable and inexplicable failure of effective oversight.

## **8. Recommendations**

In an attempt to address and resolve these issues, the staff makes four recommendations:

**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.

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<sup>73</sup> AICPA, AU 230, Due Professional Care in the Performance of Work;

**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.<sup>74</sup> The OIG examination should be coordinated with and reviewed by the U.S. Government Accountability Office (GAO).<sup>75</sup> 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. The 2012 opinion was rendered by the CPA firm CliftonLarsonAllen.<sup>76</sup>

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

**Fourth**, Senator Grassley 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.

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<sup>74</sup> AICPA AU Section 315, Communications Between Predecessor and Successor Auditors, Sections .12 and .13;

<sup>75</sup> 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;

<sup>76</sup> UKW sold its federal audit practice to Clifton Gunderson which then merged with LarsenAllen on 1/1/02;