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Bad Idea: Counting on the Pentagon Audit to Find Waste and Inefficiency

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On November 15, the Pentagon announced it had “failed” its first-ever financial audit. To be more accurate, the auditors gave the Pentagon a “disclaimer” on their books, meaning they were unable to render an opinion because the records were insufficiently available or maintained.

The number of people in Washington who were actually surprised at this result was close to zero. Indeed, the Pentagon has been telegraphing for years that it would not pass an audit on the first try, the second, or maybe even the third. As Deputy Secretary of Defense Patrick Shanahan put it when [announcing](#) the results: “We failed the audit, but we never expected to pass it.”

Lawmakers and others have long bemoaned the fact that the Pentagon has never passed a comprehensive financial audit. They regularly paint that as *prima facie* evidence of waste and inefficiency. For example, at the House Armed Services Committee’s January 10, 2018 [hearing](#) on the audit, Rep. Tom O’Halloran (D-AZ) waxed indignant upon hearing that the Department of Defense (DoD) had not yet passed the audit, saying: “I want to echo my colleagues who have rightfully stated that proper financial oversight is long overdue at DoD. Waste, fraud, abuse have no place in any agency...”

For decades, the Pentagon has struggled to comply with 31 U.S.C. §3515, as amended by the Chief Financial Officers Act of 1990, which requires it to undergo an audit. And make no mistake: the struggle is real. It has to do with scale and history.

DoD is the largest of all federal departments. It has more than \$2.7 trillion in assets and more than 2 million people spread all over the globe. And its history doesn’t help. The nation’s military, 243 years old, wasn’t

built to be audited. It was constructed incrementally over time to win wars, and today it finds itself composed of a multitude of overlapping and diverse financial and inventory systems and processes.

Pentagon Comptroller David Norquist [estimated](#) that, in 2018, the audit will cost \$918 million; \$367 million in direct costs and \$551 million to fix the problems the audit finds. That's a small fraction of the DoD's \$700 billion 2018 budget, but still enough to buy nine F-35 jet fighters.

The audit might be worthwhile if it succeeds in finding large amounts of waste and inefficiency. But it won't and frankly can't.

To understand why requires an understanding of audit wonkiness. When thinking of the audit, many imagine a swarm of auditors fanning out through DoD, asking leaders tough questions like "Why did you buy \$1,280 [coffee cups](#)?" or "Why are you spending \$26 per gallon on [biofuel](#) when you could buy regular fuel for \$2.50?" It's an appealing vision, but not at all representative of how the Pentagon audit actually unfolds.

As required by Chief Financial Officer (CFO) Act of 1990, the audit solely examines the financial statements produced by all federal agencies. To meet this requirement, the Pentagon [produces](#) four main financial statements: a balance sheet, a statement of net cost, the statement of changes in net position, and the statement of budgetary resources. The Pentagon audit devolves merely to verifying the accuracy of these statements. Thus, the Pentagon could buy literally thousands of \$1,280 coffee cups and millions of gallons of \$26 fuel, and—as long as these transactions were faithfully reported on the financial statements—it would "pass" that element of the audit with flying colors.

Private corporate financial statements carry great weight. Prospective shareholders use them to weigh the financial health of the company. But in the DoD, these arcane financial statements—which this year will cost \$918 million to verify and fix—are all but irrelevant. Strictly the remit of the cubicles in the back of the comptroller's office, the financials are not used to manage internal processes or track costs or performance. Thus, verifying the accuracy of DoD's financial statements, while no doubt satisfying at some level, carries no great potential to find and identify waste or inefficiency, and holds no promise of saving money.

Additionally, many elements of the audit duplicate existing oversight mechanisms. The audit looks at cybersecurity of DoD financial systems, an area already examined by other organizations. While verifying the DoD's balance sheet, auditors painstakingly check inventories of parts, quantities of helicopters, numbers of artillery shells—all of which are also already tracked by other DoD supply accountability processes.

Even more confounding, the conduct of the audit has required the Pentagon to place a value on every single building and part and piece of equipment it owns with little or no resulting benefit. For example, for the purposes of the audit, the Army is required to accurately place a value on all M113 armored personnel carriers—purchased in the 1960s—which have since gone through numerous upgrades and modifications. For a corporation that could be sold or may issue stock, this process has merit. But for the Pentagon, it serves no useful purpose; it simply consumes time and money. So, in essence, instead of finding waste and inefficiency, the DoD audit unwittingly creates them.

Secretary Norquist affirmed the audit didn't turn up waste or inefficiency. When releasing the results, he [admitted](#) the audit didn't "find any unspent pots of gold." Nor did the results point to evidence of [fraud](#). There were, however, a number of useful [findings](#) related to internal controls for information technology and financial reporting. But are these alone sufficient to justify the entire time, effort, and money the audit consumed? Probably not.

So what's to be done? Clearly, the Pentagon should be held accountable for the funds with which it is entrusted. No one is arguing for a "free pass" for DoD. And, because the Pentagon downplayed the importance of the audit for so many years, it now is in an unfavorable position to take the lead to advocate for any changes in the requirements.

To make the audit more effective, then, Congress must take the lead. Lawmakers must engage with the Pentagon and, together with the Federal Accounting Standards Advisory Board, implement common-sense changes to the audit. For example, they could remove non-value added areas such as balance sheet valuation and accounting for the existence and completeness of major military equipment (an area in which no problems have been found). This would allow the exercise to focus more on those areas which only the DoD

audit can cover. The sooner that gets started, the more quickly DoD can take money from the audit and apply it to readiness and other pressing needs.

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