

How the DoD Audit Process Was Compromised

Written by Sen. Charles Grassley
Friday, 13 December 2013 08:18

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Prepared Floor Statement of U.S. Senator Chuck Grassley of Iowa

“How the Audit Process Was Compromised”

Wednesday, December 11, 2013

Mr. President, I come to the floor today to talk about two important audits that were bungled by the Department of Defense (DoD) Inspector General’s (IG) Office.

There is something very important that I need to say right up-front. A brand new Inspector General, Mr. Jon Rymer, is now in place. The events I am about to describe happened several years ago. None reflect on his leadership.

When faced with a frontal assault on its audit authority by the target of one of its audits, senior IG officials got a bad case of weak knees and caved under pressure. They trashed high-quality audit work that was critical of a certified public accounting (CPA) firm’s opinions. In doing this, they covered-up reportable deficiencies. They allowed the audit target to run roughshod over sacred oversight prerogatives without uttering one word of protest or asking one single question.

I am talking about audits of the financial statements produced by the department’s central accounting agency. This is DFAS, the Defense Finance and Accounting Service. The audits were conducted by a CPA firm but supposedly under the watchful eye of the Inspector General

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or IG.

The story of the two bungled audits is told in [an oversight report](#) , which is now posted on my web site.

While I received the first anonymous email on this matter in April 2012, my audit oversight work actually began more than five years ago. It was triggered by a steady stream of tips from whistleblowers, complaining about the quality of those audits. These reports grabbed my attention.

My colleagues may wonder why the Senator from Iowa is down in the weeds on such arcane issues. The reason is simple.

Audits are probably THE primary oversight tool for rooting out fraud and waste in the government. To protect the taxpayers, Congress needs to ensure that government audits are as good as they can be. They must produce tangible results. They must be able to detect theft, waste, and mismanagement and recommend corrective action.

With mounting pressure for serious belt-tightening under Sequestration, audits have taken on even greater importance. Audits should help senior management separate the wheat from the chaff and apply mandated cuts where they belong. Sequestration cuts should be guided by hard-hitting, rock-solid audits. Unfortunately, rock-solid audits produced by the Inspector General's Office are hard to come by.

After evaluating hundreds of audits, I issued three oversight reports in 2010-12. With a few notable exceptions, I found that the Inspector General's audits were weak, ineffective, and wasteful. Yet they cost \$100 million a year to produce.

Poor leadership is part of the problem.

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But there is another driver, and that's the department's broken accounting system. It allows fraud and waste to go undetected and unchecked. That's bad enough. But the lack of credible financial information makes it very difficult to produce hard-hitting audits. Auditors are forced to do audit trail reconstruction work to connect the dots on the money trail. That is labor intensive and time consuming work.

Although the department continues to spend billions to fix the busted accounting system, it's still not working right. The department cannot pass the Chief Financial Officers (CFO) Act audit test. It is unable to accurately report on how the taxpayers' money is spent -- as it is required to do each year by law. By comparison, every other federal agency has passed the test.

So long as the accounting system is dysfunctional, audits will remain weak and ineffective and the probability of rooting out much fraud and waste during Sequestration is low.

And while I am talking about the need for better audits, I would like to offer a word of encouragement to the Special Inspector General for Afghanistan Reconstruction, John Sopko. He's the head of SIGAR for short. Well, SIGAR is cranking out aggressive, hard-hitting audits, and I commend SIGAR for that.

The audits I am about to discuss, by contrast, deserve darts -- not laurels.

Mr. President, I first came to the floor to speak on this subject on November 14, 2012. At that point, I had completed a preliminary review of seven red flags -- or potential problem areas -- that popped up on my radar screen.

Since then, I have double checked the facts. I have confirmed my preliminary observations. I did this by examining the official audit records known as "work papers."

So I will not walk that same ground again today. Instead, I will briefly summarize what I did; how I did it; what I found; why it's important; and offer some fixes for consideration.

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To conduct this investigation, I had to examine literally thousands of documents. I could not have done it without the help and guidance of CPA-qualified government auditors. Evidence uncovered in the work papers was validated with interviews and written inquiries with knowledgeable officials. Together, these tell the story of what really happened. And it's not a pretty picture.

True, my report is nothing more than a snapshot in time. But if this snapshot accurately reflects the work being produced by the IG's Audit Office, then we have a BIG problem.

In a nutshell, this is what I found:

A CPA firm, Urbach, Kahn, & Werlin (UKW), had awarded an unblemished string of seven "clean" opinions on the central accounting agency's financial statements. Then the IG stepped in and took a two-year snapshot for FY 2008-09.

It was supposed to report on whether those statements and opinions met prescribed audit standards, but due to a series of ethical blunders, that job was never finished.

A third review was planned for 2010, but after the 2008-09 fiasco, it was cancelled, allowing DFAS to rack up another string of clean opinions through 2012.

Altogether, this work probably cost the taxpayers in excess of 20 million dollars.

The work performed by DFAS in 2008-09 was sub-standard. The outside audit firm rubberstamped DFAS' flawed practices using defective audit methods.

For its part, the IG was prepared to call foul on the CPA firm for sub-standard work but got side-tracked and then steamrolled by DFAS.

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The contract gave the IG preeminent oversight authority to accept or reject the firm's opinions. The whole purpose of the contract was to position the auditors to make that determination. If the firm's opinions met prescribed standards, they would be endorsed. If not, the IG would issue a non-endorsement report.

On both the fiscal year 2008 and 2009 audits, the record clearly indicates the IG's audit team determined that the firm's opinions did not meet prescribed standards. They did not merit endorsement. Though I cannot cite work papers to prove it, whistleblowers allege that top management "ordered" them to endorse the 2008 opinion with this caveat.

If known deficiencies were not corrected in the 2009 opinion, a non-endorsement was guaranteed. Well, when the very same deficiencies popped up again, the auditors prepared a hard-hitting non-endorsement report as promised. It was signed. The transmittal letter was ready to go out the door.

The non-endorsement decision had been communicated to DFAS via email in unmistakable terms. In line with that decision and contract requirements, the IG took steps to cut-off payments to the CPA firm, based on advice of the IG's Legal Counsel.

The next step was to issue the non-endorsement report. But this is where the IG chickened out. In a power vacuum, DFAS moved swiftly to block the report with a blatant end-run maneuver to by-pass independent oversight.

DFAS neutered independent oversight by the IG with two bold moves:

-- On the same day the IG's Office notified DFAS in writing that a non-endorsement report would be forthcoming, DFAS unilaterally and "proudly" declared that it had earned a clean opinion and ordered that all disputed invoices be paid. This was an act of out-and-out defiance.

-- Next it kicked the IG off the contract. Yes, Mr. President, you heard me right. The agency being audited literally kicked the IG – the oversight agency -- clean off the oversight contract.

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In making this end-run maneuver, DFAS broke every rule in the audit book.

What happened was a frontal assault on the Inspector General's oversight authority. The frontal assault was mounted by the agency being subjected to audit and by an agency whose financial reports were found to be grossly deficient. In the face of such outright defiance, I would like to think that any IG would have stood up to the offending agency and held its ground and protected and defended its oversight prerogatives. But not the DoD IG.

Instead, the IG's knees buckled under the pressure. The IG retreated before the onslaught. The IG caved and trashed the report. The IG rolled over and played possum, giving DFAS the green light to proceed full-speed ahead.

And the IG accepted these blatant transgressions without expressing one word of criticism – without expressing one concern – without raising one single question.

Other than a lone Hotline complaint that disappeared down a black hole, no protest was ever lodged. No corrective action was ever proposed or taken.

The Inspector General's silence appeared to signal total acquiescence to a series of actions that undermined the integrity of the audit process.

For a Senator who watches the watchdogs, what I see here is a disgrace to the entire IG community. The IG allowed DFAS to run rough shod over the contract, the IG Act, audit standards, and independent oversight. And the audit firm probably got paid for work that was never performed – payments that were alleged to be improper.

Instead of exposing poor practices and improper actions by both the accounting agency and CPA firm, the OIG allowed sacred principles to be trampled. It just kept quiet, turned a blind eye to what was going on, hunkered down, and tried to cover its tracks.

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Two misguided acts set the stage for the collapse of oversight of these audits.

The problem began with the contract.

At the insistence of the department's Chief Financial Officer and accounting agency, the IG agreed to a contractual arrangement that put DFAS, the target of the audit, in the driver's seat. This contract allegedly violated the IG Act and standing audit policy, according to an Assistant IG who spoke out at the time.

To address this issue, a fragile "waiver" arrangement was crafted. It was supposed to address the legal issue and protect OIG interests under the DFAS contract. All the parties involved agreed to abide by this questionable set-up.

But being nothing more than an informal trust, it came unglued under the pressure and controversy generated by the non-endorsement decision.

Even the OIG Legal Counsel voiced grave concerns about the fragile waiver arrangement. In his opinion, the terms of contract "transferred" the OIG oversight function to DFAS, the very component whose financial data were being subjected to the oversight. In his words, 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," he said, "I would have advised against it."

The Counsel's concerns were well-founded, and like a modern day Nostradamus, his prediction has come to pass.

The second problem was a failure of leadership at the top.

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When the Inspector General's auditors reached the conclusion that the CPA firm's opinions did not measure up to prescribed standards, the current Deputy IG for Audit drove a final nail into the coffin.

The official audit records make it crystal clear. The Deputy IG gave the fateful order: "there will be no written report." This was a lethal blow. This is how the report got bottled up. True, it disappeared from public view. It got buried, and DFAS was promised it would never see the light of day, that is, until one of my investigators came along and dug it out of a pile of work papers. And here it is in my hand.

Once the Deputy IG had smothered the report, DFAS knew it had the green light to bypass oversight with impunity.

All this bungling could have harmful consequences.

First, compelling audit evidence, which undermined the credibility of the financial statements prepared by the department's flagship accounting agency, was shielded from public exposure. The suppression of that evidence has helped to immortalize the myth of DFAS's clean opinions. It's so bad now the myth is an inside joke. It's laughable, according to one former accountant. Here's what he said on the record to McClatchy News on November 22, 2013. I quote: "When I was there, DFAS would brag about getting a clean opinion. We accountants would just laugh out loud. Their systems were so screwed up."

If the output of the Defense Department's flagship accounting agency, which disburses over 600 billion dollars a year is, indeed, laughable, then Pentagon money managers have another big problem. As that famous whistleblower, Ernie Fitzgerald, liked to say: It's time to lock the doors and call the law."

Since the myth involves the reliability of data reported by the department's central accounting agency, it has the potential for putting the Secretary of Defense's audit readiness initiative in

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jeopardy. DFAS' apparent inability to accurately report on its own internal "housekeeping" accounts of 1.5 billion dollars casts doubt on its ability to accurately report on the hundreds of billions DoD spends each year. 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 Inspector General's audit process may have been compromised.

If the independence of the audit process was, in fact, compromised as my report suggests, then the department's primary tool for rooting out waste and fraud could be disabled – at least it was in these two cases.

And if that did, indeed happen, then it probably happened with the knowledge and silent acquiescence of senior officials in the IG's office, the institution that exists to root out fraud, waste and abuse.

In simple terms, the watchdog appointed to expose and stop fraud and waste may have been doing some of it himself or herself. If true, it clearly demonstrates a lack of commitment on the part of senior management to exercise due diligence in performing its core mission.

Almost all of the key players allegedly responsible for the bungled audits still occupy top posts in the IG's Audit Office today. Surely, these officials did not act alone. This was a concerted effort. According to recent news reports, other "higher-ups" were allegedly involved. But senior IG officials must bear primary responsibility for this unacceptable and inexplicable failure of oversight. They could have stopped it.

To address and resolve these issues, I made four recommendations in a recent letter to Secretary Hagel and IG Rymer:

First, the DoD CFO should "pull" the DFAS financial statements for FY's 2008 and 2009 and remove those audit opinions from official records.

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Second, the OIG needs to undertake an independent audit of DFAS' financial statements for FY 2012 and determine whether those statements and the CPA firm's opinion meet prescribed audit standards. The FY 2012 beginning account balances must also be verified. In response to my oversight, the Inspector General has initiated a "Post Audit Review" of DFAS' FY 2012 financial statements. This is a good move. But to ensure that it is done right this time, I asked the U.S. Government Accountability Office (GAO) to watch-dog the Inspector General's work. I want independent verification cause last time there was none. This process will be completed next year.

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

Fourth, I am referring unresolved concerns regarding the conduct of IG officials to the Integrity Committee of the Council of the Inspectors General on Integrity and Efficiency for further review as provided under the IG Reform Act of 2008.

What happened here, Mr. President, is almost beyond comprehension.

All of it happened under the IG's watchful eye. All of it probably happened with top-level knowledge. Most of it probably happened with top-level approval. Some of it was probably allowed to happen through tacit approval or silent acquiescence. All of it was bad for the integrity and independence of the audit process and the accuracy of financial information in the government's largest agency.

As I said a moment ago, the department has a new IG, Jon Rymer. I hope he is a genuine junkyard dog, who likes aggressive, hard-hitting audits. And I hope Mr. Rymer will take a long, hard look at what happened here and work with Secretary Hagel and others to find a good way to right the wrongs and get audits back on track. I know he can do it, and I stand ready to help him in any way I can. Mr. Rymer, my door is open to you.

I yield the floor.