



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510-6200

SEP 13 2010

Dear Senator Grassley:

My letter to you of September 10, 2010, provided my preliminary response to the report prepared by your staff, "Oversight Review of Audit Reporting by the Department of Defense, Office of Inspector General." A more detailed response to the recommendations contained in your report, as mentioned in my letter, is enclosed.

I believe that your report presents valid concerns and is an opportunity to enhance the mission of the Department of Defense Inspector General (DoD IG) in regard to detecting and reporting fraud. Therefore, I have directed the Deputy Inspector General for Auditing and her staff to make concrete and specific proposals on how your report can be used to improve the timeliness, focus and relevance of audit reports. Furthermore, I have directed that these proposals, to be completed no later than October 15, 2010, are supplemented by a detailed plan listing specific initiatives to be implemented at the earliest possible date. The recommendations in your report will be an important tool in the transformation I have initiated since being confirmed as Inspector General.

In closing, I wish to convey my gratitude to you and your staff for the efforts made on behalf of taxpayers to help improve the operations of the DoD IG. I look forward to meeting with you on September 29, 2010. In the meantime, if you wish to further discuss this issue, I can be reached at (703) 604-8300.

Sincerely,

A handwritten signature in black ink that reads "Gordon S. Heddell".

Gordon S. Heddell

Enclosure:
As stated

cc: Committee on Armed Services
Committee on Homeland Security and Governmental Affairs

Responses to Recommendations in Grassley Oversight Report of September 7, 2010

- 1. The OIG must reorder audit priorities and realign the audit organization to carry out the IG's core mission of detecting and reporting fraud and making recommendations for corrective action; Contracts and payments need to be re-coupled at the audit level; and auditors need to connect all the dots in the cycle of transactions and verify payments using primary source Defense Finance and Accounting Service records.**

RESPONSE: This report presents valid concerns and is an opportunity to examine both Audit priorities and the Audit organization to carry out the statutory mission of the DoD IG with regard to detecting and reporting fraud, as well as providing leadership and coordination in recommended policies for activities designed to promote economy, efficiency and effectiveness in the administration of the Department's programs and operations. Therefore, I have directed the Deputy Inspector General for Auditing and her staff to make concrete, specific recommendations on how we can use this report to improve the timeliness, focus and relevance of our audit reports. I have also directed the DIG-Auditing to report to me in writing no later than October 15, 2010, with a summary of her findings, recommended corrective actions, and a detailed plan of action listing specific initiatives to be implemented at the earliest possible date.

While we do have areas where we can improve, I want to mention that this office has made significant contributions to the goals you have cited. For example, for the past seven years, we conducted a series of audits on interagency contracting. These audits have resulted in the identification of 608 potential Anti-Deficiency Act violations. More importantly, the audit recommendations resulted in changes to the Department's Financial Management Regulations and these policy changes will help ensure funds are spent consistent with Congressional intent. In addition, the audit recommendations led Department managers to take 66 disciplinary actions against responsible officials.

- 2. Relying on available resources, the OIG should establish a small number of large, aggressive audit teams to conduct selective "end-to-end" contract performance and payment audits.**

RESPONSE: Audit's current work identifies challenges in DoD's contract management and helps prevent improper payments. Audit has initiatives underway to expand the number of staff assigned to audits. For example:

- Audit is expanding its efforts and the number of audit teams dedicated to identifying improper payments.

- In the acquisition arena, Audit is using an expanded audit team to identify programs that are troubled from a performance, cost, or schedule perspective and to identify programs that may be duplicative of other programs, either fielded or in development.

We do not conduct end-to-end audits of the contract process in a single audit. Rather, we provide audit coverage of key aspects of the contract process based on the associated risk for that segment such as user requirements, contract administration, and vendor payments. If user requirements are not well defined in the contract, the warfighter may not receive the goods and services needed to accomplish the mission. If contract administration is lacking, the warfighter may not get what it paid for to accomplish the mission. If vendor payments are not properly supported, misuse of funds, duplicate payments can occur and vulnerabilities exist for fraud.

Although Audit currently lacks the advanced tools needed to quickly analyze end-to-end data to determine where to quickly focus its resources, Audit is in the process of obtaining the necessary IT storage capacity and sophisticated software it needs for forensic auditing and predictive analysis. Rather than establishing a small number of large teams of up to 100 auditors, as suggested in the report, to focus on fraud, it is more efficient to use these advanced techniques, combined with our expanded emphasis on identifying improper payments under the Improper Payments Information Act.

3. The OIG needs to reset audit priorities consistent with CFO Hale's guidance and Section 1008 of the FY 2002 Defense Authorization Act; or seek relief from CFO Act.

RESPONSE: Audit realigned its oversight approach to specifically focus on the financial information in the Statement of Budgetary Resources and the Department's information supporting the existence and completeness of its assets because of Mr. Hale's new initiative. For example:

- Audit limited its financial statement audit work to the 9 audits identified by the Office of Management and Budget as being required by the CFO Act, and eliminated financial statement audits of Other Defense Organizations.
- Because of these and other efforts, our resources devoted to CFO Act financial statement audits declined from 25 FTEs in FY 2004 to 19 FTEs in FY 2009. Audit expects the FY 2010 financial statement audits will now take about 14 FTEs to complete.
- Audit will continue to work with the DoD CFO to ensure our oversight efforts are consistent with the Department's direction, the level of progress, and related statutory requirements.

Audit asked the DoD CFO if he planned on seeking relief from the CFO Act. The CFO advised us that he did not want to seek relief from the CFO Act because it was an important

part of improving the Department's financial management practices. We do not plan to seek relief from the CFO Act.

4. The Audit Office should focus on top-to-bottom, end-to-end reviews of DOD's plans and programs for modernizing its finance and accounting systems; Specifically, the FIAR and ERP or similar financial system improvements plans should be scrutinized every year; OIG should research and publish a report that projects the full costs of compliance with the Chief Financial Officers (CFO) Act by 2017.

RESPONSE: As noted in the response to recommendation 2, "end-to-end" contract performance and payout audits involve an extensive amount of resources and time to complete and which, by the very nature of their wide scope, could exacerbate the very issues the report highlights involving timeliness. Instead, we provide audit coverage of the contract process through a series of audits based on the risks associated with the specific contract segment.

To further strengthen this approach, the DoD IG focus on finance and accounting systems has been expanded to include oversight of plans and programs to acquire new accounting systems and efforts to modernize the existing systems. For example:

- During FY 2011, we plan to review the Department's Enterprise Transition Plan for completeness and accuracy. The Enterprise Transition Plan includes an acquisition strategy for new systems the Department will acquire, a list of the legacy systems that are not expected to be used in the future, milestones, performance metrics, and the resources needed to implement the plan. As such, this plan is an essential tool for guiding the Department's efforts to improve its financial reporting.
- Beginning with the first Financial Improvement and Audit Readiness Plan (FIAR Plan) in December 2005, and for each subsequent update, the DoD IG has reviewed and commented on the overall approach to DoD financial improvement efforts. Although we did not publish our comments to the FIAR Plan in a separate report, we included our comments on the FIAR in the IG Management Challenge section of the Department's Agency Financial Report.

The CFO is primarily responsible for projecting the full costs of compliance with the CFO Act. While Audit could begin an audit to determine the cost of full compliance with this Act, Audit has concerns that this data may not be readily available at the DoD-wide level or at the component level. Further, Audit has concerns that the data which is currently available would not be complete. This data would be essential to completing an audit of the full cost of DoD's compliance with the CFO Act.

5. “Audits” of policies and procedures should be significantly reduced or eliminated.

RESPONSE: Section 2 of the IG Act tasks IGs to provide leadership and coordination and to recommend policies for activities designed to promote economy, efficiency and effectiveness in the administration of the Department’s programs and operations. These audits provide significant value to the Department. It should be noted that reducing or eliminating audits of policies and procedures would negatively impact our ability to assist the Department in improving its programs – a core function under the IG Act. These types of audits also yield monetary savings. For example, the Recapitalization and Acquisition of Light Tactical Wheeled Vehicles audit resulted in DoD management halting the planned procurement of 11,500 vehicles and put \$3.84 billion to better use in FY 2010 through FY 2013.

The focus of Audit on economy and efficiency audits is intended to improve controls and, as a result, reduce the likelihood of future fraudulent payments and wasteful spending. Going forward, our expanded focus on identifying improper payments, DoD contracts, and financial management systems, combined with implementing a new team of highly trained auditors using predictive analytics to identify high risk DoD programs, will provide a more robust oversight capability and materially benefit the Department in making prudent program decisions.

6. Pending deployment of a modern accounting system, audits of financial statements should be curtailed or kept to an absolute minimum.

RESPONSE: Audit continually evaluates the level of work necessary to audit DoD’s financial statements in order to ensure that we meet the requirements of the Chief Financial Officers Act and Section 1008 of the FY 2002 National Defense Authorization Act. Over the past three years, we have tailored our audit processes so that Audit’s efforts more efficiently support these financial statement audit reports and meet audit standards and statutory requirements. For example:

- Audit limited its financial statement audit work to the 9 audits required by the CFO Act and eliminated financial statement audits of Other Defense Organizations.
- Because of these and other efforts, Audit resources devoted to CFO Act financial statement audits declined from 25 FTEs in FY 2004 to 19 FTEs in FY 2009. Audit expects the FY 2010 financial statement audits will take about 14 FTEs to complete.

7. Publication of “Boilerplate” disclaimer memorandum on un-auditable financial statements should be discontinued.

RESPONSE: The Chief Financial Officers’ Act of 1990 requires the DoD IG each year to audit 9 financial statements produced by DoD and the service components. These audits must comply with Government Auditing Standards. Consistent with these standards, the financial statement audit reports include an opinion on the financial statements, a report on internal controls, and a report on compliance with laws and regulations. These reports vary

little from year to year because DoD has made little progress addressing the long-standing pervasive internal control weaknesses that prevent the Department from producing auditable financial statements.

The DoD IG has continually evaluated the level of work necessary to comply with audit standards and support these audit reports. Furthermore, the resources expended on the annual financial statements audits have declined significantly.

8. Quick Reaction Memos should be discontinued, because they have the potential of causing the IG to take ownership of command decisions, undermining the IG independence.

RESPONSE: In order to keep pace with the rapidly changing environment that Warfighters face on a daily basis, Audit started using memorandums to rapidly communicate interim audit results and suggest corrective actions rather than wait until an audit report is finalized. Because Commanders and their Commands generally rotate in 12 months or less, they cannot afford to wait for a final audit report to begin implementing corrective actions. Quick reaction memos are used to ensure that suggested corrective actions are relevant and timely. Furthermore, this initiative was well received by the Commanders who used these memos to immediately begin addressing the auditor findings.

Quick reaction memorandums are particularly effective when life and safety issues are identified. In December 2009, we used a quick reaction memorandum to alert Commanders of unsafe wiring in a shower facility in Afghanistan. In April 2010, Audit again used a memorandum to Commanders in-theater summarizing over 100 electrical code violations that were identified during an audit. In both instances, the Commanders responded immediately to the memorandum to correct these deficiencies. Discontinuing the use of quick reaction memos would significantly affect Audit's ability to provide timely actionable recommendations to the Commanders in-theater.

Using memorandums to communicate interim audit results and suggested corrective actions is not prohibited by Generally Accepted Government Auditing Standards and these memorandums do not make decisions for management. Ultimately, it is the Command's responsibility to determine the most appropriate manner to address the identified deficiency.

9. Nearly all audits pertaining issues in the war zones can be initiated, researched and fully developed by OIG personnel in the U.S. where most contractions occur; To complete a war-related audit, a small number of auditors could be temporarily assigned to carry-out in-theater portions of audits and site inspections and delivery verification as needed.

RESPONSE: Deploying auditors in-theater for extended periods of time gives them a better understanding of the challenges faced by the Commanders and a true picture of day-to-day operations on the ground. This "on-the-ground" knowledge makes DoD IG audit findings

and recommendations realistic, which has significantly increased the credibility of the organization with the Commanders.

Furthermore, in our ongoing audit of the Afghan Security Forces Funds Audit is using multiple audit teams, located both in the National Capital Region and Afghanistan, depending upon where the records are located. However, Audit has found that many audits in Southwest Asia need to be performed by forward deployed auditors. DoD IG audits of military construction projects, base closures, and asset accountability, are best done by auditors who have experience in-theater.

Sending audit teams for short temporary duty assignments an extra burden on the Commands and disrupts critical operations necessary to prevail in these combat zones.

10. To maximize the effectiveness of OIG audit reports, they should be completed and published within 6 to 9 months.

RESPONSE: I recently began a significant leadership effort to review our audits quarterly to identify which ones are taking an unusually long time to complete and how we can develop solutions to resolve them quickly. We also have a team evaluating the way we communicate our audit findings and we will obtain an independent Lean Six Sigma review of our processes to identify opportunities to further reduce the time it takes to publish audit reports.

The time it takes to complete the audit and issue the report is affected in large part by the scope of the audit, the magnitude and complexity of the DoD programs, and efforts to ensure audit quality. As a result, some audits will extend beyond the recommended 6 to 9 month timeframe.

11. Every OIG audit should give a pass/fail opinion; If a program or contract receives a failing grade, OIG should establish a timeline for compliance.

RESPONSE: Issuing only a “pass or fail opinion” would contradict Government Auditing Standards and could be misleading. In many instances, DoD IG audits identify areas that need to be corrected, but also confirm positive aspects of the program. A pass/fail grade is too limiting and would constrain auditors in providing a complete perspective in an objective and impartial manner. Audit standards require us to communicate the results in a manner that is less susceptible to misunderstanding and present sufficient evidence to support the findings and conclusions. These reports help management officials understand the need for corrective actions consistent with our findings and recommendations. While auditors can provide objective information for consideration, ultimately DoD management is responsible for determining when corrective actions will be implemented and how this will be accomplished. If Audit were to assume this responsibility, it would impair our independence.

12. OIG needs to start holding military and civilian officials at all levels accountable for financial mismanagement; If and where appropriate, audit reports should identify responsible officials and make recommendations for personnel action, as determined by DOD.

RESPONSE: We agree that the Department should hold officials accountable for failed or failing programs, or for misconduct. Where appropriate, our audit reports will continue to identify responsible officials in these instances and make recommendations to management that they consider taking appropriate personnel action. Ultimately, DoD officials must decide whether to take corrective action, as this is a management, not a DoD IG function. In addition, if our auditors identify or suspect non-criminal misconduct by senior officials (i.e., general and flag officers, as well as political appointees and Senior Executive Service managers), they will make referrals to the Deputy Inspector General for Administrative Investigations to address these matters.

In the past, some of our audit reports have made recommendations to management for corrective action that led to personnel actions. For example, our series of audits on interagency contracting identified 608 potential Anti-Deficiency Act violations, valued at about \$551 million. As a result of these audits, the Department took the following 66 disciplinary actions:

- issued 12 oral reprimands,
- issued 44 written reprimands,
- suspended one individual for three days,
- suspended one individual for five days without pay,
- reassigned and reduced one individual to a lower grade,
- fired three individuals,
- fired and placed another individual under house arrest,
- dismissed one individual who was sentenced to probation and had to pay restitution,
- dismissed another individual who was sentenced to a federal penitentiary, and
- relieved one Commander.