



Defense Department Audit Report Card

In November 2019, the Defense Department (DoD) issued its latest annual Agency Financial Report. The financial statements in this report underwent the second consecutive full-scope, department-wide audit. The DoD received another disclaimer (failing) audit opinion on its financial statements, but appears to be making progress addressing issues that undermine the trustworthiness of DoD financial management.

With this report, Truth in Accounting ranks DoD component entities based on their fiscal year (FY) 2019 audit performance. We issue this ranking to identify relative strengths and weaknesses in financial reporting, to track progress over time, and to identify agency leaders who serve as good examples for the department as a whole.

Background

In 1990, the Chief Financial Officers Act directed federal agencies (including the DoD) to prepare and present audited financial statements, unless the agency asserted that its statements were not auditable. Such was the case for the DoD for nearly 20 years, at least until FY 2018.

This helps explain why the DoD has long been the principal culprit responsible for two decades of annual disclaimer (failing) opinions on the consolidated financial statements for the entire United States Government.

With two years of DoD-specific audit results, we can compare the data over time. However, the auditors are also on a learning curve, and they have been identifying new problems faster than it resolves outstanding issues.

Auditors identified 20 material weaknesses in their review of agency-wide reporting in FY 2018, and this year the number of material weaknesses actually rose to 25. While DoD component entities closed about one-third of the notices of findings and recommendations (NFRs) from the FY 2018 audit, the auditors identified more than twice as many new findings in FY 2019 as they closed from last year.

The DoD Inspector General issued a helpful report in late January titled “Understanding the Results of the Audit of the DoD FY 2019 Financial Statements.” Based on that report and our own analysis of the audit opinions for the DoD component entities, we have developed the scoring and ranking system described in the appendix.

Findings

The scores and ranking for the entities are listed in the table on page four of this report. They are ranked from highest (best) to lowest (worst).

Based on our review, we recognize these four entities for delivering the best performance in the latest audit:

- **U.S. Army Corps of Engineers - CW**
- **Military Retirement Fund**
- **Defense Health Agency - CRM**
- **Department of Veterans Affairs**

Other DoD entities can learn from their example and improve their auditability in the years ahead.

Note that the main military branches – the Army, Navy, Air Force, and Marines -- all rank in the lower half of

the table. They are also among the largest entities, posing significant financial management challenges. But we believe good accounting systems are even more important for the large military branches, and we challenge them to improve and rise in the rankings.

The DoD Inspector General’s report “Understanding the Results of the Audit of the DoD FY 2019 Financial Statements” does not include the Department of Veteran Affairs (VA). We include the VA, however, in this analysis because defense spending is much larger than just Defense Department expenses. The U.S. government spends massive defense-related dollars in other departments, including the VA, the Energy Department, the State Department, the Department of Homeland Security, and the Department of the Interior. We believe the VA, at least, belongs in a consolidated audit of “defense” financial reporting.

Truth in Accounting is a 501(c)(3) nonpartisan, nonprofit organization whose mission is to provide citizens with understandable, reliable, and transparent government financial information. Truth in Accounting cuts through politicization and accounting tricks to show the true fiscal condition of the federal, state, and local governments.

The U.S. Army Corps of Engineers – Civil Works Program

The U.S. Army Corps of Engineers provides engineering, design and construction management services to the armed forces as well as a broader range of public projects. The Civil Works Program (USACE-CW) provides project development and maintenance services for water resource and navigation management projects, including locks and dams, and also builds and manages flood control systems.

The USACE-CW was one of a few Defense Department agencies to assert it was ready for audit in the years before the first DoD-wide audit. And it proved that it was indeed audit-ready, earning an unmodified (clean) audit opinion for the 11th consecutive year.

Notable [USACE leaders](#) include [Thomas Steffens](#). The USACE-CW 2019 agency financial report is [available here](#).

Military Retirement Fund

The Military Retirement Fund (MRF) accumulates funds to finance the DoD's liabilities for military retirement and survivor benefit programs. The MRF covers members of the Army, Navy, Air Force, Coast Guard, and Public Health Service. The MRF is a defined benefit plan, with annual retirement payments totaling about \$40 billion for more than 1.5 million retirees.

The MRF does not have a CFO, but it is overseen by a financial management committee and a board of actuaries. The MRF's unmodified audit opinion did not identify a single material

reporting weakness or any instances of noncompliance with laws and regulations, in either of the last two years.

Clean opinions and ranking well on our audit scores aren't necessarily a sign of financial strength, however. The MRF reported nearly \$900 billion in total assets in 2018, but also reported \$1.8 trillion in liabilities, leaving a negative net position of nearly \$900 billion.

The MRF's 2019 agency financial report is [available here](#).

Defense Health Agency - Contract Resource Management

The Defense Health Agency (DHA) supports and coordinates health care services delivery to members of the Army, Navy and Air Force. It provides leadership for the DoD in achieving greater integration and efficiency in clinical and business processes for the Military Health System.

The DHA's Contract Resource Management arm (DHA-CRM) provides budget consultation, budget execution and contract and financial statement preparation services. Significant agency leaders include [Thomas McCaffrey](#) and [Eric Hyde](#).

The DHA-CRM 2019 agency financial report is [available here](#). Although the DHA-CRM received a clean audit opinion, the "Statements of Net Cost" mistakenly labeled gain as (loss) and vice versa in the section of the statement dealing with actuarial assumption changes.

Department of Veterans Affairs

The Department of Veterans Affairs provides a wide variety of services to military service members and their families, including disability compensation, transition assistance, educational opportunities, life insurance, and pensions.

The VA makes its 2019 agency financial report [available here](#). Significant leaders include [Secretary Robert Wilkie](#) and [CFO John Rychalski](#).

The VA provides an example for how a large and complex entity can achieve good audit results.

We base our score on ten criteria. The **OPINION** criteria is weighted at 40 percent. The **ACCESS, NFRs, NFRs-REISSUED, MATERIAL WEAKNESSES, NON-COMPLIANCE** and **TIME** criteria are each weighted at 5 percent. And now that we have another year of audit results, we include three new criteria to measure progress—**NFRs-CLOSED** as a share of previous year NFRs, the **CHANGE IN THE NUMBER OF MATERIAL WEAKNESSES (dMW)**, and the **CHANGE IN THE NUMBER OF INSTANCES OF NON-COMPLIANCE (dNC)**. We weight each of these last three at 10 percent.

Rising **NFRs** and material weaknesses currently reflect a learning curve for auditors and **DoD** financial managers, as they become more familiar with financial processes and identify new issues that need to be addressed. We are pleased with this progress, which provides our scorecard with a more accurate count of **NFRs** and material weaknesses.

OPINION: This is the audit opinion. An unmodified (clean) opinion means the auditor deemed the statements were fairly presented and consistent with generally accepted accounting principles (GAAP). A clean opinion receives five points in our framework. A qualified opinion means the statements are presented fairly and consistent with GAAP, with noted material exceptions. A qualified opinion receives three points. The auditor delivers a disclaimer of opinion if it determines it cannot obtain sufficient evidence to render an opinion. A disclaimer of opinion receives one point. An adverse opinion earns zero points.

ACCESS: This is based on the ease of

finding the entity's annual financial report and audit opinion from the home page of the entity's website. Fifty percent of the score for this criteria is based simply on whether there is a link to the annual report on the home page. The balance of the score is derived from "yes or no" answers to questions regarding whether the Inspector General's transmittal letter is easily available in the annual report PDF, and whether the PDF has a table of contents with links. We rank the 18 entities on their results for these elements, and then assign them scores of one (worst) to five (best) for the "Access" criteria.

NFRs: This is based on the number of Notices of Findings and Recommendations (NFRs). Auditors issue NFRs to identify specific weaknesses in business practices and information processing controls. The 18 component entities are ranked from top to bottom on the number of NFRs, and then assigned scores of one through five based on the number of NFRs.

NFRs-REISSUED: This is based on the number of reissued NFRs. The 18 component entities are ranked from top to bottom on the number of reissued NFRs, and then assigned scores of one through five based on the number of reissued NFRs.

NFRs-CLOSED: This is based on the percentage of previous year NFRs closed in the current year. The 18 component entities are ranked from top to bottom on this percentage, and then assigned scores of one through five based on the share of previous years NFRs that were closed.

MW: This is based on the number of identified material weaknesses. Material weaknesses are defined in federal audits as "deficiencies in internal control over financial reporting that result in a

reasonable possibility that management will not prevent, or detect and correct, a material misstatement in its financial statements in a timely manner." The 18 component entities are ranked from top to bottom for the number of material weaknesses, and then assigned scores of one through five based on the number of material weaknesses.

dMW: This is the change in the number of material weaknesses (positive or negative) from the previous year. The 18 component entities are ranked from top to bottom for the change in the number of material weaknesses, and assigned scores from one through five.

NC: This is based on the number of identified instances of noncompliance with laws and regulations. The 18 component entities are ranked from top to bottom for the number of instances of noncompliance, and then assigned scores of one through five based on the number of instances of noncompliance.

dNC: This is the change in the number of instances of noncompliance (positive or negative) from the previous year. The 18 component entities are ranked from top to bottom for the change in the number of instances of noncompliance, and assigned scores from one through five.

TIME: This is based on the number of days after the fiscal year end that the audit opinion letter was delivered. We use the modified date on the entity's annual financial report to date those reports. The 18 component entities are ranked from top to bottom for the number of days, and then assigned scores of one through five.

Ranking of DoD Component Entities

Overall		OPINION	ACCESS	NFRs	NFRsR	NFRsC	MW	dMW	NC	dNC	TIME
4.10	U.S. Army Corps of Engineers - CW	5	3	4	2	5	4	3	4	3	3
3.95	Military Retirement Fund	5	3	5	1	2	5	3	5	3	4
3.90	Defense Health Agency - CRM	5	3	5	1	3	4	3	4	3	3
3.75	DoD IG	5	1	1	1	3	4	5	5	3	1
3.70	Department of Veteran Affairs	5	5	1	3	3	3	4	2	2	2
3.65	Defense Contract Audit Agency	5	4	1	1	3	5	3	1	3	3
3.60	Defense Commissary Agency	5	4	1	1	3	5	3	1	3	2
3.35	Defense Finance and Accounting Service	5	1	1	1	3	4	3	1	3	1
2.90	Medicare-Eligible Retiree Health Care Fund	3	3	5	1	3	4	2	4	1	5
2.20	U.S. Air Force	1	3	2	4	3	1	3	3	3	5
2.15	U.S. Army	1	3	2	4	4	1	2	2	4	3
2.15	Defense Information Systems Agency	1	1	4	2	5	3	3	2	3	1
2.05	U.S. Marine Corps	1	3	3	3	1	3	3	3	3	4
2.00	U.S. Special Operations Command	1	3	4	2	4	3	2	3	1	3
1.90	U.S. Transportation Command	1	3	3	3	3	2	1	4	2	3
1.85	U.S. Navy	1	3	1	5	2	1	1	3	3	4
1.80	Defense Logistics Agency	1	3	2	5	1	1	2	1	3	4
1.75	Defense Health Program	1	1	3	3	1	2	3	3	3	1

*Each entity is scored based on ten criteria: the auditor's **opinion**, the ease of **access**, the number of **NFRs**, the number of **NFRs-reissued**, the number of **NFRs-closed**, the number of **material weaknesses**, the **change in the number of material weaknesses**, the number of noncompliance instances, the **change in the number of noncompliance instances**, and the amount of **time** after the fiscal year-end the report was published. Please see page three for a breakdown of the scoring criteria.*

