



Defense Department Audit Report Card

With this report, Truth in Accounting releases a ranking of 21 Department of Defense (DoD) component entities based on their performance in recent financial statement audits. We present this ranking to identify relative strengths and weaknesses in DoD components' financial reporting, and to identify agency leaders who serve as good examples for the department as a whole.

We recognize four entities that stand out for performing well compared to their peers, and several others whose poor financial record-keeping stand in the way of clean audits of the DoD and the entire federal government.

Background

On November 15, 2018, the U.S. Department of Defense issued its latest annual Agency Financial Report. The report was notable for including the results of the DoD's "first full-scope, department-wide, financial statement audit." Back 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, until the latest fiscal year.

The DoD has long been the principal factor leading to a disclaimer (flunk)

opinion on the financial report of the United States Government. While the DoD asserted it was audit-ready this year, it received a disclaimer of opinion on the department-wide financial statements once again. Most DoD component entities received a "disclaimer" opinion on their most recent financial statements.

The DoD did undergo its "first full-scope financial statement audit," a valuable (and very expensive) step. Understanding which DoD entities are and are not in a state of good audit readiness can help provide a path toward truthful and transparent financial practices.

The DoD Inspector General issued a helpful report earlier this year titled "Understanding the Results of the Audit of the DoD FY 2018 Financial Statements." Based on that report, and our own analysis of the auditor opinions for the DoD component entities, we have developed the scoring and ranking system described on page three. (Note: we chose to include the Department of Veteran Affairs.)

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 2018 audit:

- **Military Retirement Fund**
- **Defense Finance and Accounting Service**
- **Defense Contract Audit Agency**
- **U.S. Army Corps of Engineers**

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

Note that four of the five lowest-scoring entities are the main military branches – the Army, Navy, Air Force, and Marines. 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 challenge them to rise in the rankings next year.

A brief introduction to the best-performing entities is on page two.



Best-Performing DoD Entities

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 \$40 billion for about 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 auditor opinion derived in part from the auditor not identifying a single material reporting weakness nor any instances of noncompliance with laws and regulations. Clean opinions and ranking well on our audit scores aren't necessarily a sign of financial strength, however.

The MRF reported more than \$800 billion in total assets in 2018, against \$1.6 trillion in reported liabilities, and a negative net position of more than \$800 billion.

The MRF's [2018 agency financial report is available here.](#)

Defense Finance and Accounting Service

The Defense Finance and Accounting Service (DFAS) is the "paymaster" for

the DoD. It pays employee salaries, travel reimbursements, and commercial invoices for DoD contractors. It also has management responsibility for foreign military sales transactions. Last year, DFAS processed more than 100 million pay transactions, 6 million travel payments, and 13 million commercial invoices. It reported making more than \$500 billion in disbursements.

Notable [DFAS leaders](#) include Director Teresa McKay and Principal Deputy Director Audrey Davis. The DFAS [2018 agency financial report is available here.](#)

Defense Contract Audit Agency

The Defense Contract Audit Agency (DCAA) was created in 1965 to serve as a department-wide auditor. The military branches had previously established their own audit functions. The DCAA also provides accounting and advisory services to DoD contracting officers.

The DCAA is led by the Undersecretary of Defense (Comptroller) / Chief Financial Officer, David Norquist, the CFO of the DoD. Norquist also led the overall "first full DoD audit" last year. The DCAA conducts specialized audits of contracts and contracting practices, not financial statements, and plays a key role in securing trustworthy procurement and purchasing practices.

The DCAA [2018 agency financial report is available here.](#)

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

Notable [USACE-CW leaders](#) include Assistant Secretary of the Army R.D. James and Chief Financial Officer Thomas Steffens. The USACE-CW [2018 agency financial report is available here.](#)

Criteria and Scoring

We based our score on seven criteria. The **OPINION** criteria is weighted at 35 percent, the **ACCESS** criteria at 20 percent, the Notices of Findings and Recommendations (**NFRs**), NFRs reissued (**NFRsR**), the material weaknesses (**MW**) and noncompliance (**NC**) criteria each at 10 percent, and the **TIME** criteria at five percent.

OPINION: This is the auditor’s 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 opinion when it deems accounting weaknesses so material that the auditor cannot render an opinion. A disclaimer opinion receives **one point**. None of the entities received an adverse opinion, which means the statements do not fairly present the organization’s financial position.

ACCESS: This is based on the ease of finding the entity’s annual financial report and auditor 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 transmittal letter is easily available in the report PDF, and whether the PDF has a table of contents with links. We rank the 21 entities on their results on 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 21 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.

NFRsR: This is based on the number of reissued NFRs. NFRs are reissued if there was no resolution from the previous year. The 21 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.

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 21 component entities are ranked from top to bottom on the number of material weaknesses, and then assigned scores of one through five based on the number of material weaknesses.

NC: This is based on the number of identified instances of noncompliance with laws and regulations. The 21 component entities are ranked from top to bottom on the number of instances of noncompliance, and then assigned scores of one through five based on the number of instances of noncompliance.

TIME: This is based on the number of days after the fiscal year end that the auditor’s opinion letter was delivered. The 21 component entities are ranked from top to bottom on the number of days, and then assigned scores of one through five based on the number of days.



Ranking of DoD Component Entities

Overall		OPINION	ACCESS	NFRs	NFRsR	MW	NC	TIME
4.25	Military Retirement Fund	5	2	5	4	5	5	4
4.15	Defense Health Agency -- CRM	5	1	5	5	5	5	4
4.00	Defense Finance and Accounting Service	5	1	3	5	5	5	5
4.00	Defense Contract Audit Agency	5	4	1	1	5	5	5
4.00	U.S. Army Corps of Engineers	5	3	4	3	5	3	3
3.55	U.S. Department of Veteran Affairs	5	5	1	1	4	1	2
3.45	Medicare-Eligible Retiree Health Care Fund	3	2	5	4	5	4	4
3.30	DOD Office of Inspector General	5	2	2	2	5	1	3
2.95	Defense Comissary Agency	3	1	4	4	3	4	4
2.55	Defense Health Agency -- DHP	1	3	3	5	2	4	4
2.40	U.S. Transportation Command	1	2	2	5	4	4	3
2.40	Defense Information Systems Agency -- GF	1	2	5	5	4	2	1
2.30	Defense Information System Agency -- WCF	1	2	4	5	4	2	1
2.20	U.S. Special Operations Command	1	2	3	3	4	3	3
2.10	Defense Logistics Agency -- GF	1	3	2	2	3	3	3
2.00	Defense Logistics Agency -- TF	1	3	1	1	4	3	3
1.95	U.S. Marine Corps	1	2	3	3	3	1	4
1.90	U.S. Navy	1	2	2	3	2	3	3
1.90	U.S. Army	1	3	2	2	2	2	3
1.70	U.S. Air Force	1	1	2	3	2	3	3
1.60	Defense Logistics Agency -- WCF	1	2	1	1	3	2	3

*Each entity is scored based on seven criteria: the auditor's **opinion**, the ease of **access**, the number of **NFRs**, the number of **NFRs-reissued**, the number of **material weaknesses**, 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.*

