

**Waste, Fraud, Cost Overruns, and Auditing at the Pentagon**  
**Committee on the Budget**  
**U.S. Senate**  
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Good morning, my name is Tom Spoehr and I am the Director of the Center for National Defense at The Heritage Foundation, and a retired Army Lieutenant General. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

Thank you for the opportunity to appear before this committee.

This is a vitally important topic. No federal organization should be exempt from the imperative to be as efficient, effective, and free from fraud as possible. The U.S. Department of Defense (DOD), with nearly 20 million employees, an annual budget of over \$700 billion, and more than \$3 trillion worth of assets has a special obligation be a good steward of the resources entrusted to it for the nation's defense.<sup>1</sup>

No organization is perfect, and the Department of Defense is not immune to instances of waste, overruns, and fraud. Every option and opportunity must be explored to find new ways for the Pentagon to be more efficient. No one gets a free pass. And, given the amount of oversight agencies, safeguards, and reforms under which the Department of Defense operates, it is my opinion that *the Pentagon today is one of the most scrutinized and reformed organizations in the federal government.*

**The Pentagon Is Subject to Oversight from Multiple External and Internal Agencies**

Multiple organizations, such as the General Accounting Office (GAO), the Office of the Inspector General, audit agencies at all levels, the Defense Contract Audit Agency, service contracting offices, the now-annual financial audit, and hundreds of legal offices, all operate to ensure proper processes and that laws are followed.

In fiscal year (FY) 2020, the Department of Defense Inspector General's office alone, consisting of 1,750 individuals, issued 138 audit and evaluation reports, conducted 35 administrative investigations, and recovered \$2.69 billion dollars.<sup>2</sup>

In March 2021, the GAO found that the "DOD continues to demonstrate a strong commitment, at the highest levels, to improving the management of its weapon system acquisitions," and that "DOD leadership continued its commitment to financial management improvements."<sup>3</sup>

Thousands of pages of acquisition rules exist, with more published each year, strictly guiding acquisition and contracting decisions. Myriad annual reports, such as an annual performance plan and agency financial assurances, are prepared and published. Tough ethics laws are in place and

rigorously enforced. Determined individuals can still perpetrate fraud, but the DOD and Congress have succeeded in making it difficult.

### **The Size of the Pentagon Budget**

Some argue that the Pentagon budget is overly large, indeed “bloated” and riddled with waste. Some further argue that Pentagon spending has grown unchecked, now representing the largest part of the federal discretionary budget.<sup>4</sup>

Just because something is big does not mean it is bloated. Dwayne “The Rock” Johnson is big, yet no one would accuse him of being bloated.

National defense now consumes the smallest portion of the U.S. federal budget in a hundred years— 5 percent—and continues to shrink.<sup>5</sup> And, except for a moment in 1999, spending on national defense now consumes the smallest percentage of the U.S. gross domestic product in modern history.<sup>6</sup>

Critics also invoke the statement that DOD’s funding is bigger “than the next 10 nations’ military budgets combined”<sup>7</sup> as grounds for claiming that the budget is overly large and unnecessary.

Some added context and explanation is necessary.

First, when adjusted for purchasing power parity, an internationally recognized method of equating economies, comparisons of national defense spending reflect U.S. defense spending in terms of its purchasing power to be roughly equal to that of two countries (China and Russia)—not 10.<sup>8</sup>

The second, and more significantly overlooked element, is that the United States—for better or worse—is a global power with worldwide responsibilities. U.S. defense commitments include agreements with NATO, Japan, South Korea, Israel, Australia, and New Zealand, as well as international sea lanes and other areas. Other countries do not share similar responsibilities, and it is misleading to compare the U.S. to others without that context.

In the end, the best way to assess the size of the U.S. defense budget is to understand how well the budget allows the nation to execute its current national defense strategy. It should be no surprise that this type of assessment is also the most difficult to perform.<sup>9</sup>

### **The Pentagon’s Aggressive Reform Efforts**

No other federal department has undergone the sheer number of reforms and efficiency drives as the Pentagon has in the past five years. In many cases at the direction of Congress, the Department of Defense has converted its defined benefit retirement plan to a hybrid defined contribution plan,<sup>10</sup> cut headquarters sizes by 20 percent,<sup>11</sup> completely revamped the manner in which health care is delivered to members of the military and produced a new acquisition framework<sup>12</sup> to acquire capabilities.

Pentagon efficiency efforts, such as the Defense-Wide Review<sup>13</sup> undertaken by former Secretary of Defense Mark Esper, or the famous “Night Court” review in the Army,<sup>14</sup> largely go unnoticed by the public, even though they saved billions of dollars.

The GAO largely supported the DOD’s December 2020 claim that it had identified \$37 billion dollars in savings that could be applied to other defense programs.<sup>15</sup>

In addition, every year Congress levies new reform initiatives.<sup>16</sup> There were 88 new acquisition initiatives in the FY 2017 National Defense Authorization Act alone. The 2021 National Defense Authorization Act topped 1,450 pages, many of which are new initiatives and policies to be implemented by the DOD. Some have made the argument it is more that the Pentagon can keep up with.<sup>17</sup>

### **Fraud in the Defense Department**

Any type of fraud within the DOD represents a problem that must be eliminated. There is a challenge to put the issue into context. Indeed, the Air Force was lambasted in 2018 for purchasing coffee cups for KC-10 aircraft that cost \$1,280 apiece. Overlooked was that it *was the Air Force itself that identified the problem* and stopped buying the cups before it even came to the public’s notice.<sup>18</sup>

Fraud, just like in civil society, exists in the Pentagon and its supporting supplier base. For example, a 2018 report on defense contracting fraud found that in the preceding five years there had been 1,059 criminal cases brought against 1,087 defendants and that nearly \$800 million had been returned to the government.<sup>19</sup>

That the DOD continues to pursue such cases so vigorously helps to deter future instances of fraud. Continued vigilance by all parties is essential for combatting fraud.

### **The DOD Financial Audit Isn’t the Answer**

Some point to the Pentagon’s inability to pass an audit as prima facie evidence that the Pentagon is unworthy of the funding it is provided. Congress imposed the requirement for the DOD to pass a financial audit back in 1990, even though passing an audit is no guarantee that an organization is well managed.<sup>20</sup> Indeed, Enron, the poster child for corporate abuse, managed to pass all its financial audits, right up until the moment it imploded as a result of massive fraud.<sup>21</sup>

The Pentagon has undergone three full audits in the past four years, not passing any of them. Indeed, the result of each has been a “disclaimer of opinion,” auditor talk for “the books were in such a state that the auditors could not render an opinion.”<sup>22</sup>

Each year, the DOD fixes the previous year’s notices of findings and recommendations (NFRs), and each year a similar number of new NFRs are noted. At a recent hearing, the acting DOD Comptroller predicted that it would now take until 2028 for the Pentagon to pass the audit.<sup>23</sup> It is unclear whether that estimate is realistic.

Albert Einstein is credited with saying that the definition of insanity is doing the same thing over and over, and expecting different results.

It is not for lack of trying that the Pentagon has not passed the audit. The audit is larger in scope and size than any other attempted of its kind, dissecting a vast global enterprise of more than 20 million people. To perform this audit is both expensive and time-consuming, and in many cases duplicates existing DOD oversight mechanisms.

The 2017 audit cost nearly a billion dollars—\$367 million to conduct the audit, and \$551 million to fix the issues it discovers.<sup>24</sup> Subsequent years have carried similar costs.

U.S. corporations by law undergo strict annual financial audits to assure potential investors in capital markets of the soundness of their offerings as described in their financial statements. But the DOD is not a corporation and has no such corresponding need.<sup>25</sup>

Of course, conducting the audit is the law of the land and must be accomplished for that purpose. *But there should be more justification to continue to spend a billion dollars a year unless the expected payoff at the end is expected to outweigh the costs.* Most experts, however, believe that passing the audit will not cause the DOD to become appreciably more efficient or better managed.<sup>26</sup>

The audit carefully examines DOD financial statements: a consolidated balance sheet, a consolidated statement of net cost, a consolidated statement of changes in net position, and a combined statement of budgetary resources.<sup>27</sup> These statements are currently not used for any management purposes within the DOD, and senior leaders do not consult them in decision-making.<sup>28</sup>

**Certain Elements of the DOD Financial Audit Have Value.** There are some elements, which, if tackled and fixed, would provide value added. Tracing and fixing problematic financial transactions might prove useful. Improvements to the DOD's financial information technology (IT) systems would be beneficial. But many elements of the audit, such as verifying physical property existence, completeness, and valuation (portions of which demand that the DOD recount physical property, such as F-35 fighters and World War II buildings) or placing an accurate value on a 1960s-era armored personnel carrier—carry no real value.

Other requirements, such as determining proper access to IT systems, are already covered by other DOD processes, and addressing them in the financial audit is redundant.

Congress should take the immediate opportunity to work with the Pentagon and the auditing community to narrow and focus the effort of the financial audit to include only those items, which, if fixed, would be expected to add direct value to management and financial operations of the Pentagon.

## Areas Where Savings and Efficiencies Are Possible

Although the Pentagon has undergone several reforms in recent years, there are still opportunities where Congress can help to make the Department of Defense more efficient.

Congress should authorize another round of Base Realignment and Closure (BRAC), even if the Pentagon does not ask for it. The Pentagon has previously said that it could save \$2 billion a year with another round of BRAC.<sup>29</sup>

Congress should allow public-private competitions previously authorized under OMB Circular A-76 to take place. Such competitions normally generated a 20 percent to 30 percent cost savings, regardless of whether the government or private industry wins the competition.<sup>30</sup>

Congress should allow the DOD to carry over a small portion, perhaps 5 percent, of its operating and maintenance accounts to the next fiscal year to reduce the pressure of year-end “use it or lose it” spending, which is generally less effective spending.<sup>31</sup>

Given the anticipated flat budget for 2022, Congress should view with caution Pentagon attempts to divert funding to costly projects in pursuit of fighting climate change---such as converting the DOD’s entire fleet of non-combat vehicles to electric by 2030 and expensive biofuels---unless a clear warfighting value is present.<sup>32</sup>

Finally, Congress should exercise its oversight function to confirm only those nominees who have the significant management and business experience necessary to lead the Department of Defense and have the proven capability to push an organization to higher levels.<sup>33</sup>

## Conclusion

Thank you for the opportunity to testify. This is a vitally important topic. Nothing I have said should be taken to mean that the Pentagon deserves a free pass on efficiency. Indeed, the Pentagon must do better.

There are no quick and easy solutions to making the Pentagon more efficient. Solutions will be hard-won and focused on discrete problems. Tough-minded and educated leaders are needed to implement change. But “hard” does not mean “impossible,” and nothing is more important to the long-term future of this country than an effective and efficient national security apparatus.

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