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How to Improve Financial Management at the Department of Defense

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Senator Tom Coburn (R–OK) proposes to freeze all base budget non-military personnel accounts at the Department of Defense (DOD) until the department complies with the law regarding auditable financial statements. While the precise language of the proposal has yet to be revealed, there are at least four laws with which the DOD is non-compliant and that will form a basis for Senator Coburn's proposal.

The Senator is right to be pressing the DOD to improve its financial management system. Since the objective is to make the most efficient and effective use of U.S. tax dollars dedicated to defense, Congress should adopt a strategy that would achieve that goal. Freezing the use of assets could disrupt legitimate programs, in the long run increasing both expenses and waste. The right way to address financial management problems is to adopt the proven practices used by the private sector to drive out inefficiency without weakening a company's capacity to deliver goods and services to its customers.

DOD Efforts to Improve Financial Management. Under Senator Coburn's leadership, the strategy of pressing for reform has produced results. The DOD has been working toward the goal of a "clean audit opinion" since 2001. At that time, \$879 billion in DOD assets and liabilities—25 percent of the total—received unqualified audit opinions. As a result of the Financial Improvement and Audit Readiness Plan, which was developed in 2005, the number had increased to \$1.3 trillion by 2007. By 2009, \$2.4 trillion—more than two-thirds of all DOD assets and liabilities—received audit opinions.¹

The DOD's program for improving financial management is necessarily an incremental one, but real progress is being made. According to the DOD, weaknesses in internal financial control decreased by 84 percent between 2001 and 2007. Errors resulting in duplicate payments have also decreased. The DOD's Fund Balance with the Department of the Treasury, which identifies the portion of the DOD budget available for spending, is effectively 100 percent accurate. Military and civilian personnel payments are more than 99 percent accurate.²

Right and Wrong Approaches. Impatience with the DOD over achieving a clean audit opinion across all of its assets and liabilities, however, should not be an excuse for doing the wrong thing, such as freezing the overall budget. Ultimately, these improvements should be sought for the purpose of increasing DOD capabilities through better management. A freeze represents an attempt to use the ruler of decreased capabilities to measure improved financial management.

Obviously, untargeted reductions in funding would succeed in reducing DOD capabilities. Reducing its capabilities, however, does not necessarily mean that the DOD will manage its resources more effectively or efficiently. Indeed, untargeted

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funding reductions almost inevitably lead to greater inefficiency because they undermine the DOD's ability to plan its programs on a sustained basis.

The better approach is to use the improvements that the DOD has already attained in the area of financial management to identify targeted cuts in the budget and redirect the savings to other areas of the DOD where the resources would be put to better use. For example:

- Greater accuracy in the DOD's military personnel payments could lead to pay increases;
- Money saved as a result of proper and timely payment of invoices and the corresponding reduction in interest penalties could be plowed back into acquisitions; and
- The funds saved as a result of improved audits by the Defense Contract Auditing Agency, which resulted in \$2.4 billion in savings from audits conducted in 2007 alone, could be restored to the acquisitions account.

Best Practices for Defense Funding. The DOD should manage its finances according to best practices. Senator Coburn is correct in continuing his demand that the DOD reach the goal of a clean audit of all its assets and liabilities. Evidence suggests that it is making progress toward reaching this goal, but putting all elements of the DOD's budget under the threat of a freeze is not the best way to make this demand.

A more discriminating approach is needed, one that adds to the DOD's overall ability to meet the American people's demand that the federal government provide for their defense. The private sector offers numerous lessons in this regard. Senator Coburn's approach, however, is counterproductive.

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1. U.S. Department of Defense, Office of the Under Secretary of Defense (Comptroller), "Improving Financial Performance," at <http://comptroller.defense.gov/improving.html> (February 14, 2011).
2. *Ibid.*