

# WebMemo



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## Enforce Financial Management Requirements at the Department of Defense

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Among the amendments pending to the National Defense Authorization Act for Fiscal Year 2012 before the Senate is one sponsored by Senator Kelly Ayotte (R-NH) that seeks to move up the date in the law for the Department of Defense (DOD) to produce auditable financial statements. The amendment would move this date up from 2017 to 2014. This is in keeping with a pledge made in October by Secretary of Defense Leon Panetta to make the DOD audit-ready in half the time.

The Senate is right to be pressing the DOD to improve its financial management system. The objective is to make the most efficient and effective use of U.S. tax dollars dedicated to defense, and it is appropriate to hold Secretary Panetta to his pledge. It would be counterproductive, however, for Congress to impose penalties on DOD, such as even more drastic reductions in defense expenditures in addition to those already required under the Budget Control Act of 2011. Such penalties would disrupt legitimate programs, increasing both expenses and waste in the long run. This is a central weakness in the sequestration process established by the Budget Control Act, which will be applied if things stand as they are now. 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.** In fact, Congress's strategy of pressing for reform has produced results. The DOD has been working toward what it calls a "clean audit opinion"—in line with private-sector accounting standards—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.<sup>1</sup> Accordingly, Panetta should have a running start toward meeting his expedited goal, and it is reasonable for the Senate to expect that he will reach this goal.

**Right and Wrong Approaches.** Impatience with the DOD should not be an excuse for doing the wrong thing, such as imposing additional defense budget reductions. Ultimately, financial records improvements should be sought for the purpose of increasing DOD's capabilities through better management. Congress should not impose financial

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penalties on the DOD now, but instead should provide DOD with the resources to fulfill its missions while insisting on accountability. In fact, running the DOD in an efficient manner—and meeting its mission requirements—will require vastly larger resources than those permitted under the sequestration process.

Obviously, untargeted reductions in funding would reduce DOD capabilities. Reducing its capabilities, however, does not necessarily mean that the DOD will manage its resources more effectively or efficiently. In fact, untargeted 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 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. This should be the aim of the Ayotte amendment and Secretary Panetta's plan. 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 acquisition; 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.

The DOD should manage its finances according to best practices. A more discriminating approach—one that adds to the DOD's overall ability to meet the American people's demand that the federal government provide for their defense—should be the purpose of the Ayotte amendment. The private sector offers numerous lessons in this regard. Secretary Panetta should note these lessons as he seeks to fulfill his pledge to make DOD audit-ready at an earlier date.

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1. Baker Spring, "How to Improve Financial Management at the Department of Defense," Heritage Foundation WebMemo No. 3156, February 16, 2011, at <http://www.heritage.org/research/reports/2011/02/how-to-improve-financial-management-at-the-department-of-defense>.