RollingStone

Has the Government Legalized Secret Defense Spending?

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October 4th, 2018, was a busy news day. The fight over Brett Kavanuagh's Supreme Court nomination dominated the cycle. The Trump White House **received a supplemental FBI report** it said cleared its would-be nominee of wrongdoing. Retired Justice John Paul Stevens meanwhile said Kavanaugh was compromised enough that he was "**unable to sit as a judge**."

#NationalTacoDay trended on Twitter. Chris Evans **told the world** production wrapped on *Avengers 4.*

The only thing that did not make the news was an **announcement** by a little-known government body called the Federal Accounting Standards Advisory Board — FASAB — that essentially legalized secret national security spending. The new guidance, "SFFAS 56 – CLASSIFIED ACTIVITIES" permits government agencies to "modify" public financial statements and move expenditures from one line item to another. It also expressly allows federal agencies to refrain from telling taxpayers if and when public financial statements have been altered.

To Michigan State professor Mark Skidmore, who's been **studying** discrepancies in **defense expenditures** for years, the new ruling — and the lack of public response to it — was a shock.

"From this point forward," he says, "the federal government will keep two sets of books, one modified book for the public and one true book that is hidden."

Steven Aftergood of the **Federation of American Scientists' Project on Government Secrecy**was one of the few people across the country to pay attention to the FASAB news release. He was alarmed.

"It diminishes the credibility of all public budget documents," he says.

I spent weeks trying to find a more harmless explanation for SFFAS 56, or at least one that did not amount to a rule that allows federal officials to fake public financial reports.

I couldn't find one. This new accounting guideline really does mean what it appears to mean, and the details are more bizarre than the broad strokes.

The FASAB ruling adds a new and confusing wrinkle to what little we know about levels of spending in the intelligence community. Officially, the fiscal year 2019 appropriation **is $81.1 billion**, which breaks down to $59.9 billion for the National Intelligence Program, along with $21.2 billion for the **Military** Intelligence Program.

This made a few headlines, as Trump's "black budget" request was described as the **largest in history**. However, as Aftergood notes, even the high FY '19 numbers do not include spending

for "classified DoD operations and procurement." Add now the possibility of future "modifications," and the real answer for how big a share of national spending belongs to the intelligence community is probably "God only knows."

Given that the intelligence budget number the government admits to is already larger than the annual *defense* budgets of **all but two countries on earth** (our own and China's), it seems natural to ask: what are we getting ourselves into?

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The story of openly secret budgets really began in 1949, with the passage of the **Central Intelligence Agency Act**. The law exempted the newly christened spy agency from public financial disclosure.

The CIA Act was a radical departure from the Constitution, which is clear about public accounting (emphasis mine):

"No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of **all public Money** shall be published from time to time."

The CIA Act created a blunt constitutional carve-out.

"The sums made available to the **Agency** may be expended **without regard to the provisions of law** and regulations relating to the expenditure of Government funds," the law read. "For objects of a confidential, extraordinary, or emergency nature, such expenditures to be accounted for solely on the certificate of the **Director**…"

In other words, while other government agencies had to account for their expenses, the word of the CIA director was good enough when it came to what they'd spent and why.

In a few accidental disclosures in the Fifties, CIA expenses **appeared** as Department of Defense **line items**, despite the fact that the CIA is not a Defense agency.

No one much worried over this issue until the early Seventies. That's when a series of scandals — from botched assassination attempts abroad to the discovery of legally proscribed domestic spying programs — invited closer scrutiny of the CIA. The most famous oversight effort came in the form of Idaho Senator Frank Church's famed 1975 **committee hearings** scrutinizing America's intelligence agencies.

At roughly the same time as the Church hearings, an insurance adjuster named William Richardson got fed up and filed suit against the U.S. government. Richardson wanted secret CIA budgets declared unconstitutional. He barely made the news (his suit was a **page 8 blip** in the *New York Times*).

Nonetheless, he went all the way to the Supreme Court, and by a thin margin (a 5-4 vote) the court ruled against Richardson, **upholding the concept of secret budgets**.

Chief Justice Warren Burger wrote the majority opinion. Citing an earlier ruling, he in essence said a random citizen whose only problem was that he didn't know where his taxes were going did not have standing to waste the high court's time.

"A taxpayer," Burger wrote, "may not 'employ a federal court as a forum in which to air his generalized grievances about the conduct of government.'"

Fast-forward 16 years, when, in the second year of George H.W. Bush's presidency, Congress passed the **Chief Financial Officers Act of 1990**.

This new law was aimed at curbing "billions of dollars" said to be "lost each year through fraud, waste, abuse, and mismanagement" of public budgets.

It demanded that 23 major federal agencies — including the Departments of Defense, Justice, Interior and many others — designate a CFO and file regular reports.

These reports were to be in the form of "complete, reliable, timely and consistent financial information for use by the executive branch."

To create a more uniform standard for this reporting, the government created FASAB in **that same year**. The new "Accounting Standards" bureau was designed to help make apples-to-apples comparisons between budgets of government departments. With the passage of the CFO Act, the Pentagon was supposed to begin delivering intelligible numbers about its expenditures. It did not.

Year after year passed without audits. Finally, Congress appropriated money to hire outside auditors like Ernst & Young to do the work, which was to be completed last year.

On November 15th, 2018, however, the Department of Defense **failed its first audit**, which was conducted by 1,200 auditors. This was after 26 years of what Sen. Chuck Grassley (R-IA) called "hard-core foot-dragging."

"We failed the audit, but we never expected to pass it," Deputy Secretary of Defense Patrick Shanahan said at the time.

That the Pentagon failed its audit was no surprise. There had already been significant hints that even the supposedly legal version of defense budgeting was an indecipherable morass.

On the day before 9/11, for instance, then-Defense Secretary Donald Rumsfeld announced that, according to some estimates, "**we cannot track $2.3 trillion in transactions**." The following day's events obviously distracted the media from that shock announcement.

In 2015, the Office of the Inspector General found the Army alone — which had a budget of $122 billion that year — had **$6.5 trillion** in "yearend adjustments" they could not "adequately support."

Skidmore recalls being dumbfounded by the numbers.

"When I saw that first report from 2015, with the $6.5 trillion, I thought, 'That's impossible, that can't be,'" he says.

2018 was to be the year when we finally got answers to questions about defense spending. Early results were not encouraging. Outside auditors found that just one Pentagon outfit, the Defense Logistics Agency, **could not account for over $800 million** in construction transactions.

Later that year, the DoD flunked its audit, and little-known FASAB quietly issued a new guidance that may make future disclosures even more remote. The new rule appears to smooth the way for permanent classification of national security expenditures.

Formal discussion of the new FASAB rule seems to have begun on August 30th, 2017, at a meeting of the FASAB board. In a staff briefing memo sent to board members ahead of the meeting, a 1999 declaration from then-CIA Director George Tenet argued against the disclosure of "topline budget numbers" for things like the National Intelligence Program — you know, the program that the was budgeted at $59.9 billion for 2019.

"Disclosure of the budget request reasonably could be expected to provide foreign governments with the United States' own assessment of its intelligence capabilities and weaknesses," Tenet said in 1999. "The difference between the appropriation for one year and the Administration's budget request for the next provides a measure of the Administration's unique, critical assessment of its own intelligence programs."

In the briefing memo sent ahead of the meeting, it was suggested FASAB "allow certain types of departures from other standards when needed." However, these "departures" would be limited to public financial statements, and in amounts that would "reconcile in aggregate" to schedules or other documentation subject to review.

From there, the Board solicited comments from a series of federal agencies and outside experts about the efficacy of allowing secret "modification[s]" of public financial statements.

In reply came 17 **comment letters**, including from private accounting firms like KPMG and Kearney & Company. Most of the federal agencies solicited seemed more than happy with the idea of having the authority to "modify" their public financial disclosures. Homeland Security gave a big thumbs-up.

"DHS agrees with the Board's overall proposed approach for protecting classified information. Classified information should be protected," it wrote, with redundant satisfaction.

This made sense, coming from Homeland Security. Why, however, was the Department of Housing and Urban Development so thrilled? Ben Carson's agency seemed actively pleased with the idea of allowing the government to move accounting line items from one agency to another.

"If an entity's identification would disclose there is classified information," HUD's comment letter read, "it makes sense to include that organization in another entity."

I asked assistant director of FASAB Monica Valentine if such a thing could happen under the new rule: "Could an expenditure be moved from [Department of Defense] to HUD?"

"Because of the classified nature of this topic, I will not respond to specific examples," Valentine replied.

However, another government source told me flat out that the new rule would not involve moving line items between agencies. It's not clear, however, how firm a line that is.

Late last year, for instance, we saw an incident in which two employees of the National Reconnaissance Office and the NSA were arrested for procurement fraud in Colorado in a case involving a classified signals intelligence program. In that instance, the site turned out to be owned **by the Department of Health and Human Services**.

In any case, not all of the comment letters FASAB solicited last year were positive. Several expressed serious concerns. Perhaps the harshest reply came from the office of the Inspector General for the Department of Defense, which **flatly disagreed** with the proposed changes.

"This proposed guidance is a major shift in Federal accounting guidance," the agency wrote. It added, "This approach would likely make the financial statements misleading to all but a select few individuals that are aware of the Interpretation."

Others expressed concern that under the new rules, federal agencies would not even be required to tell the public they've made a "modification."

KPMG, for instance, **wrote**, "We believe that component reporting entities should be required to disclose that modifications of presentations and omissions of disclosures were made."

Kearney & Co. didn't see the need for such a major change, and suggested continuing the current practice of simply redacting sensitive information.

"Financial statements of classified entities should remain classified or redacted like other classified documents before release to the public," they wrote.

The firm added, "Allowing only select individuals to view and accept the interpretations would limit due process and transparency."

Despite these and other objections, on October 4th of last year, FASAB issued a news release about SFFAS 56. The text of the new rule strongly resembled the original proposal. The money quote:

This Statement permits the following

– *an entity to modify information required by other standards if the effect of the modification does not change the net results of operations or net position;*

– *a component reporting entity to be excluded from one reporting entity and consolidated into another reporting entity*

In plain English, the new guidance allowed federal agencies to "modify" public financial statements, with essentially a two-book system. Public statements would at best be unreliable, while the real books would be audited in "classified environment[s]" by certain designated officials.

When I asked FASAB who would be doing the auditing in "classified environment[s]," they answered:

"Please contact the federal entity's Office of the Inspector General for questions pertaining to who does the auditing in a classified environment."

This new rule is not confined to a few spy agencies. It appears to allow a stunningly long list of federal agencies to make use of new authority to "modify" public financial statements.

The Treasury Department's definition of a "component reporting entity" **includes 154 different agencies and bodies**, from the Smithsonian Foundation to the CIA to the SEC to the Farm Credit Administration to the Railroad Retirement Board. The notion that any of these agencies

could now submit altered public financial reports under the rubric of national security is mind-boggling.

When asked why this authority extended to so many agencies and not just those with national security mandates, FASAB replied:

"We use a standard scope paragraph in all of our standards. We have never named specific reporting entities in the scope paragraph. Also – we cannot anticipate what the name of a future entity might be. It is simply more practical to make the standards broadly applicable."

In a strange twist, paragraph 8a of the new rule seems to insist that modifications may only be made if it does not "change the net results of operations." In conversations with federal officials, this was stressed to me, that the new rule would not allow for changes to "total net cost" line items on public financial disclosures.

However, paragraph 8c of the same rule reads:

"An entity may apply Interpretations of this Statement that allow other modifications to information required by other standards, and the effect of the modifications may change the net results of operations and/or net position."

This directly contradicts 8a, and seems to allow in some cases for changes even to total net position numbers. When asked on the record if 8c opened the door for greater changes, FASAB answered, "We cannot speculate about the changes."

One thing is certain: the taxpayer who opens up a **federal financial statement** expecting to find correct numbers will no longer be sure of what he or she is reading. Bluntly put, line items in public federal financial statements may now legally be, for lack of a better word — wrong.

Moreover, the state is not required to include a disclaimer telling the reader that modifications have been made.

"FASAB's answer would probably be they would use this authority responsibly and only when necessary," says Mandy Smithberger of the Project on Government Oversight. "Unfortunately, that goes against fifty years of experience when it comes to national security spending."

"That's what makes this so crazy. The list of agencies is so long," says Skidmore. "If you don't even know what's been modified, why bother reading a summary for any of them?"

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This obscure new accounting guideline should be understood in the context of a longstanding debate about the need for budget transparency versus the need to "protect" classified information.

The Brown-Aspin Commission, formed by Congress in the mid-Nineties to examine a series of intelligence-related issues, was sharply critical of the non-transparent accounting of intelligence programs.

"Information on intelligence programs has not been organized to facilitate decision-making," the Brown-Aspin authors **wrote**, "or to provide outside reviewers, such as [Office of Management and Budget], with an informed view."

The commission was dismissive of the idea that publishing bulk amounts of national security expenditures posed any kind of risk. The CATO Institute reported at the time that three former CIA directors **also agreed** with the assessment. Nonetheless, the commission's suggestions on this issue were not implemented.

Other democracies, including nations with whom we share intelligence like Australia, New Zealand, Canada and Britain, publish their intelligence budgets.

Beyond these guidelines, the United States already admits very little detail in its national security financial reports.

Despite what Tenet appears to have argued, it's hard to understand what possible justification there could be in concealing from the public sheer amounts of spending for agencies like the CIA, NSA or the Defense Intelligence Agency.

"If this authority is used to obscure those top-line numbers," says POGO's Smithberger, "that would suggest the potential for abuse."

Smithberger expressed hope that someone in Congress would make an official effort to learn more about what the new ruling means, and how exactly it will be implemented.

Given the government's track record in failing to force transparency out of the Pentagon, it's hard to have a lot of confidence answers will be forthcoming.

Catherine Austin Fitts was Assistant Secretary for Housing and Urban Development during the George H.W. Bush administration. She's been working with Skidmore on defense accounting issues for two years.

She was so alarmed about the new FASAB ruling she commissioned an **in-depth study** of "Standard 56" for her site, the **Solari Report**. In the introduction, the report writes bluntly that SFFAS 56 is:

"…taking government accounting practices from laxly enforced reporting standards to a new benchmark entirely–expressly approved obfuscation of reporting and, in some cases, outright concealing financials."

Reached by email, Austin Fitts was pessimistic about the meaning of the new rule.

"The White House and Congress just opened a pipeline into the back of the US Treasury," she wrote, "and announced to every private army, mercenary and thug in the world that we are open for business."

What the rule actually will mean in practice is not clear. But it's not hard to imagine how it could be employed. A quick look in the historical rearview mirror offers more than a few hints.

The Iran-Contra affair was, at its core, an accounting issue. In it, a group of actors used proceeds of weapons sales to fund unauthorized support of Nicaraguan rebels. Money was moved from one place to another, with the public cut out of the loop.

Is it possible this new authority would make such behaviors, if not legal exactly, at least legally invisible?

This would fall in line with the pattern of post-9/11 America. So much about intelligence programs in the War on Terror era seems already beyond oversight.

We've been told little-to-nothing about drone assassinations and warrantless detention, and it took a high-profile whistleblower like Edward Snowden to break the news of a vast new domestic surveillance program (something about which former National Intelligence Director James Clapper was **willing to lie under oath**).

A legalized dualistic system for public financial reporting would therefore just be the latest blow to federal transparency, but it would be a big one. It would be nice to get a few answers before paying taxes into a black box becomes a permanent feature of American life.