United States Government Accountability Office

Report to Congressional Requesters

July 2015

DOD FINANCIAL MANAGEMENT

Actions Are Needed on Audit Issues Related to the Marine Corps' 2012 Schedule of Budgetary Activity

Accesisible Version

GAO-15-198

GAO Highlights

Highlights of GAO-15-198, a report to congressional requesters

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Why GAO Did This Study

After being identified in August 2009 as the pilot military service for an audit of its SBR, the Marine Corps received disclaimers of opinion on its fiscal year 2010 and 2011 SBRs. Because of difficulties in locating supporting documents for prior fiscal years, in June 2012, DOD leadership decided that the Marine Corps would prepare and subject to audit a Schedule of Budgetary Activity that would include only current year activity on fiscal year 2012 appropriations. In December 2013, the DOD OIG issued an unqualified opinion on the Schedule.

GAO was asked to assess the 2012 audit results. GAO (1) determined the extent to which the OIG's audit met professional standards, (2) analyzed the status of Marine Corps actions on recommendations, and (3) identified any DOD-wide implications from the audit. GAO reviewed auditor documentation, re-performed certain tests, evaluated Marine Corps corrective action plans and statuses, and determined whether other military services and DOD would likely encounter similar issues. GAO met with DOD OIG auditors and Marine Corps and DOD Comptroller officials.

What GAO Recommends

GAO makes three recommendations related to the quality of DOD OIG audits. The OIG agreed with GAO's recommendations, but disagreed with many of its findings; the Marine Corps disagreed with certain findings; and the Office of the DOD Comptroller generally agreed with GAO's findings on the DOD-wide audit readiness implications from GAO's work. GAO acknowledges DOD's continuing efforts to become audit ready. GAO maintains that its findings are accurate.

View GAO-15-198. For more information, contact Asif A. Khan at (202) 512-9869 or khana@gao.gov.

What GAO Found

GAO found that in certain key audit areas, the Department of Defense (DOD) Office of Inspector General (OIG) did not perform sufficient procedures, under professional standards, and consequently did not obtain sufficient, appropriate audit evidence to support the audit opinion on the Marine Corps' Fiscal Year 2012 Schedule of Budgetary Activity (Schedule). GAO found that the OIG did not perform sufficient procedures to determine (1) the completeness of transactions reported on the Schedule, (2) the reliability of certain evidence used to support transactions included on the Schedule, (3) whether budgetary activity was recorded in the proper period and shipment obligations were properly recorded. In addition, the OIG did not properly consider and evaluate the audit evidence in concluding and reporting on the results of the audit.

For example, about half of the Marine Corps' reported fiscal year 2012 budgetary activity originated in non-payroll feeder systems. However, the OIG did not perform sufficient procedures to determine the completeness of the data transferred to the general ledger from the non-payroll feeder systems, although the OIG had reported control weaknesses over feeder system transfers in the 2 prior year audits that the Marine Corps had not yet fully addressed. Also, the OIG did not perform sufficient procedures to determine the reliability of data in certain feeder systems that were used as support when the Marine Corps could not locate or provide original support for some of the OIG's sampled transactions. The OIG stated that certain audit testing in subsequent audits was expanded to address GAO's concerns.

On March 23, 2015, the OIG withdrew its fiscal year 2012 audit report, stating that facts identified in the audit of the Marine Corps' fiscal year 2014 Schedule raised questions about the completeness of information on which the 2012 opinion was based. The OIG has indicated that once additional information has been gathered and analyzed, it will revisit its fiscal year 2012 audit opinion in light of its analysis and determine whether the report should be reissued.

GAO also found that the Marine Corps had made limited progress in addressing auditor recommendations since the audit of its fiscal year 2010 Statement of Budgetary Resources (SBR). For example, as of December 2013, the Marine Corps had not completed action on 130 of the 177 OIG recommendations. In commenting on GAO's report, the Marine Corps noted that it has subsequently remediated numerous recommendations. GAO has not assessed these subsequent corrective actions.

GAO identified DOD-wide implications from the Marine Corps audit related to challenges in assuring the (1) completeness of budgetary transactions, (2) reliability of data generated by DOD agencies' business processes and systems, and (3) proper fiscal year recording of obligations and outlays. Actions to address these challenges will help ensure the reliability of DOD component agencies' financial information; however, until such actions are complete, DOD and its component agencies likely will continue to face significant challenges in having reliable budgetary information for decision making on DOD missions and operations and achieving auditability of their budgetary information.

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Abbreviations

AICPA	American Institute of Certified Public Accountants
CFO	Chief Financial Officer
CHOOSE	Cash History On-Line Operator Search Engine
DCAS	Defense Cash and Accountability System
DEAMS	Defense Enterprise Accounting and Management System
DDRS	Defense Departmental Reporting System
DDRS-AFS	Defense Departmental Reporting System-Audited Financial Statements
DDRS-B	Defense Departmental Reporting System-Budgetary
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DOD	Department of Defense
ERP	enterprise resource planning
FASAB	Federal Accounting Standards Advisory Board
FIAR	Financial Improvement and Audit Readiness
FISCAM	*Federal Information System Controls Audit Manual*
FFMIA	Federal Financial Management Improvement Act of 1996
FMFIA	Federal Managers' Financial Integrity Act
GAAP	generally accepted accounting principles
GAGAS	generally accepted government auditing standards
GCSS-MC	Global Combat Support System-Marine Corps
IPAC	Intergovernmental Payment and Collection

MCTFS	Marine Corps Total Force System
MILSTRIP	Military Standard Requisitioning and Issue Procedures
OIG	Office of Inspector General
OMB	Office of Management and Budget
QMD	Quantitative Methods Division
SABRS	Standard Accounting, Budgeting, and Reporting System
SAS	Statement on Auditing Standards
SASSY	Supported Activities Supply System
SBR	Statement of Budgetary Resources
SSAE	Statement on Standards for Attestation Engagements
Treasury	Department of the Treasury
USSGL	*United States Standard General Ledger*
WITS	Web Interfund Transaction Search

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July 30, 2015

The Honorable Ron Johnson
Chairman
The Honorable Thomas R. Carper
Ranking Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Claire McCaskill
Ranking Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable John McCain
Chairman
Committee on Armed Services
United States Senate

In August 2009, the Under Secretary of Defense (Comptroller)/Chief Financial Officer (hereafter referred to as the DOD Comptroller) designated the General Fund Statement of Budgetary Resources (SBR)[1] as a major financial audit priority for the Department of Defense (DOD) and announced the selection of the Marine Corps[2] as the pilot military service for an audit of the SBR. The Marine Corps was selected because it is the smallest military service, has a single standard general ledger system, and has an integrated military personnel and payroll system. The SBR is a required financial statement for federal government entities, and is the only financial statement predominately derived from an entity's budgetary accounts in accordance with budgetary accounting rules, which are incorporated into generally accepted accounting principles (GAAP) for federal government entities. The SBR and related disclosures are

[1]General funds are accounts in the U.S. Treasury holding money not allocated by law to any other fund account.

[2]The Marine Corps is a military service that is organizationally placed within the Department of the Navy.

designed to provide information on authorized budgeted spending authority reported in the Budget of the United States Government (hereafter referred to as the President's Budget),[3] including budgetary resources, availability of budgetary resources, and how obligated resources have been used.[4] In concert with the analysis of other budgetary data, the SBR's linkage to the President's Budget helps assess the reliability of budgetary data reported in the President's Budget. The proper preparation and audit of the SBR is key to this assessment.

After assessing its ability to locate documentation supporting its budgetary transactions, the Marine Corps asserted that it was audit ready (i.e., prepared to undergo an audit of its fiscal year 2010 SBR). The DOD Office of Inspector General (OIG) contracted with a public accounting firm (audit firm) for assistance in conducting the audits of the Marine Corps' SBRs for fiscal years 2010, 2011, and 2012. The DOD OIG issued disclaimers of opinion on the Marine Corps' fiscal year 2010 and fiscal year 2011 SBRs.[5] The disclaimers were the result of a scope limitation caused by the Marine Corps' inability to provide timely, sufficient audit documentation for recorded transactions, particularly with regard to prior year transactions that supported beginning balances of obligations. As a result of the difficulty in locating supporting documentation for an SBR audit, in June 2012, with the approval of the DOD Comptroller, the Marine Corps reduced the scope of its fiscal year 2012 audit to include only current year transaction activity on fiscal year 2012 appropriations presented in a General Fund Schedule of Budgetary Activity (General

[3]Budgetary activity reported in the SBR and Schedule of Budgetary Activity corresponds with accumulated budgetary information on federal agency budget authority, obligations, and outlays (spending) reported in the completed fiscal year, referred to in the President's Budget as the actual year. For example, Marine Corps actual fiscal year 2012 budgetary information is reported in the "2012 actual" column of the Program and Financing schedules for each appropriation as reported in the *Fiscal Year 2014 Appendix, Budget of the U.S. Government*. A portion of the Marine Corps' budgetary information also is reported in the Program and Financing schedules for appropriations it shares with the Navy.

[4]Budgetary resources include the amount available to enter into new obligations and to liquidate them. Budgetary resources are made up of new budget authority and unobligated balances of budget authority provided in previous years.

[5]In issuing a disclaimer of opinion, the auditor does not express an opinion on the financial statements. A disclaimer of opinion is appropriate when the scope is not sufficient to enable the auditor to express an opinion.

Fund Schedule).[6] The Marine Corps intended this effort to be a building block toward a complete SBR audit covering all open appropriation years, as subsequent fiscal year budgetary activity was audited. For fiscal year 2012, the Marine Corps reported $28.7 billion in General Fund appropriations and $21.1 billion in net outlays (spending, net of offsetting collections[7] and receipts). On December 20, 2013, the DOD OIG issued an unqualified ("clean") opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule.

You asked us to assess the results of the Marine Corps' fiscal year 2012 audit. Our objectives were to (1) determine the extent to which the audit was performed in accordance with professional auditing standards; (2) analyze the status of the Marine Corps' actions to address identified accounting, financial reporting, and information technology system control weaknesses; and (3) identify any DOD-wide implications from the Marine Corps' fiscal year 2012 audit results.

To address our first objective, we analyzed the auditor's documentation on all aspects of the audit to determine the extent to which (1) the audit was performed in accordance with professional auditing standards and (2) the auditor's reported conclusions were supported by the documented audit evidence. To address our second objective, we analyzed pertinent documentation on the status of the Marine Corps' corrective actions on auditor recommendations from its fiscal years 2010 through 2012 audits. We identified closed recommendations and determined whether (1) corrective actions had been appropriately designed to address reported weaknesses and (2) documentation on closed recommendations confirmed that actions to address them had been completed. For our third objective, we analyzed issues identified in our work and considered whether DOD and the other military services relied on many of the same systems, processes, and controls as the Marine Corps and would be likely to experience similar issues in their audits. During our work, we met with DOD OIG auditors and the audit firm to discuss the performance of the audit. We met with Marine Corps officials to discuss the status of corrective actions on recommendations from its fiscal year 2010 through

[6]An appropriation is a form of budget authority to incur obligations and to make payments (outlays) for specified purposes and fiscal years.

[7]Offsetting collections are collections from government accounts or from transactions with the public. These collections are credited to appropriation or fund accounts.

2012 audits and the status of actions on our previous recommendations.[8] We also had periodic discussions with DOD Comptroller and Financial Improvement and Audit Readiness (FIAR) Directorate officials to discuss DOD FIAR Plan Status Reports and FIAR Guidance related to military service and service-provider audit readiness.[9]

We conducted this performance audit from July 2012 through July 2015 in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Further details of our scope and methodology are presented in appendix I.

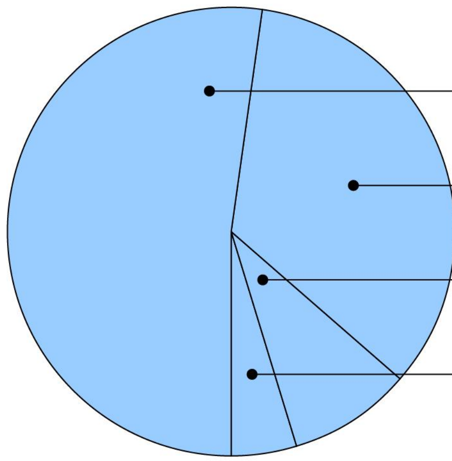
Background

The Marine Corps was established on November 10, 1775, to provide security to naval vessels and boarding parties and to conduct limited land engagements in support of naval operations. In fiscal year 2012, the Marine Corps reported that it had about 198,000 active duty marines, 39,000 reservists, and 22,000 civilian employees. At any given time, approximately 30,000 marines are deployed in operations supporting the nation's defense or military operations other than war. The Commandant of the Marine Corps has overall responsibility for Marine Corps operations, including the operating forces and supporting bases, air stations, and installations. To support its core mission, the Marine Corps received $28.7 billion in General Fund appropriations for fiscal year 2012—or 16.6 percent of the Department of the Navy's appropriations. Figure 1 shows the amounts of the Marine Corps' appropriations, including allocations of funds from appropriations shared with the Navy.

[8] GAO, *DOD Financial Management: Marine Corps Statement of Budgetary Resources Audit Results and Lessons Learned*, GAO-11-830 (Washington, D.C.: Sept. 15, 2011).

[9] The DOD Comptroller established the FIAR Directorate in 2005 to develop, manage, and implement a strategic approach for addressing internal control weaknesses; achieve financial audit readiness; and integrate those efforts with other improvement activities, such as the department's business system modernization efforts. The DOD Comptroller and FIAR Directorate issued the first FIAR Plan in 2005 as DOD's strategic plan for guiding financial management improvement.

Figure 1: Marine Corps Fiscal Year 2012 General Fund Appropriations Received



Source: U.S. Marine Corps Fiscal Year 2012 Agency Financial Report. | GAO-15-198

Note: The Marine Corps shares five appropriations with the Navy and receives its share of the funding through Navy allocations of budget authority.

Long-standing DOD Financial Management Weaknesses and Marine Corps SBR Audit Readiness History

The Marine Corps' efforts to achieve audit readiness for its budgetary data were conducted within DOD's overall high-risk environment. GAO's High-Risk Series includes DOD risks related to weaknesses in financial management operations, business transformation, and business system modernization.[10]

Long-standing DOD Financial Management Weaknesses

DOD has acknowledged that long-standing weaknesses in its internal controls, business systems, and processes have prevented it from demonstrating that its financial statements are reliable, including information on budgeted spending reported in its SBR. Our February 2015 High-Risk Series updates on DOD financial management, business transformation, and systems modernization reported that the department had made limited progress in resolving long-standing weaknesses in these areas. DOD has undertaken several financial management improvement initiatives over the years to address weaknesses in business systems, processes, and controls through its FIAR strategy,

[10] GAO, *High-Risk Series: An Update*, GAO-15-290 (Washington, D.C.: Feb. 11, 2015).

semiannual FIAR Plan Status Reports, and financial management reform methodology contained in the FIAR Guidance. DOD also spends billions of dollars annually to maintain key business processes and operations and acquire modern systems that are fundamental to achieving its business transformation goals, including systems that support key functions, such as personnel, financial management, health care, contract management, acquisition, supply chain, and logistics.[11] However, progress in making system and process improvements has been slow, and weaknesses in these areas have adversely affected the efficiency and effectiveness of DOD operations and hindered DOD's ability to achieve financial audit readiness.

While the department has made some progress toward demonstrating leadership commitment and developing capacity and action plans in all three areas, DOD continues to face challenges in monitoring corrective actions and demonstrating progress. In August 2013, we reported that DOD risk management policies associated with preparing auditable financial statements through the FIAR Plan are not in accordance with widely recognized guiding principles for effective risk management.[12] For example, DOD has not addressed key risks associated with its component agencies' reliance on service providers for significant aspects of their financial operations and their inability to maintain documentation to support transactions. In addition, DOD has continued to identify a department-wide need for qualified and experienced personnel—not only at working levels, but also in senior leadership positions—as a risk to achieving its financial management improvement and audit readiness goals.[13] Because our related reports include numerous recommendations to DOD for addressing these and other financial management and audit

[11]GAO, *Defense Business Transformation: DOD Has Taken Some Steps to Address Weaknesses, but Additional Actions Are Needed*, GAO-15-213 (Washington, D.C.: Feb. 11, 2015), and *Defense Business Systems: Further Refinements Needed to Guide the Investment Management Process*, GAO-14-486 (Washington, D.C.: May 12, 2014).

[12]GAO, *DOD Financial Management: Ineffective Risk Management Could Impair Progress toward Audit-Ready Financial Statements*, GAO-13-123 (Washington, D.C.: Aug. 2, 2013).

[13]GAO, *DOD Financial Management: Actions Under Way Need to Be Successfully Completed to Address Long-standing Funds Control Weaknesses*, GAO-14-94 (Washington, D.C.: Apr. 29, 2014), and *Human Capital: DOD Should Fully Develop Its Civilian Strategic Workforce Plan to Aid Decision Makers,* GAO-14-565 (Washington, D.C.: July 9, 2014).

readiness weaknesses, we are not making additional recommendations related to these matters in this report.

Marine Corps SBR Audit Readiness History

The Marine Corps initially asserted that it was ready to undergo an audit of its fiscal year 2009 General Fund SBR on September 15, 2008. However, after reviewing the status of the Marine Corps audit readiness efforts, on April 10, 2009, the DOD OIG reported that the Marine Corps' assertion of audit readiness was not accurate and that the documentation supporting its assertion was not complete. Although the Marine Corps made progress toward audit readiness during fiscal year 2009, the DOD OIG reported that a number of issues led auditors to conclude that an audit of the Marine Corps' fiscal year 2009 SBR would not have positive results. For example, the OIG stated that after 3 months of extensive effort by the Marine Corps, adequate supporting documentation was received for only 74 percent of the sampled budgetary transactions. The DOD OIG reported that unless the issues were resolved, the risk of a disclaimer of opinion would be high. The DOD OIG also reported that the Marine Corps had identified remediation activities that needed to be accomplished before an audit of its SBR was undertaken. The DOD OIG suggested that the Marine Corps consider requesting an audit of its fiscal year 2010 SBR. The OIG subsequently contracted for assistance from an audit firm in performing an audit of the Marine Corps' fiscal year 2010 SBR. Because the Marine Corps asserted SBR audit readiness at the beginning of fiscal year 2010, it was not subject to DOD's May 2010 FIAR Guidance, which required each DOD component to review its processes and controls to identify needed corrective actions and develop a financial improvement plan with roles, responsibilities, and milestone dates for completing actions on assessable units as part of a component-level, overall financial improvement and audit readiness plan.[14]

In September 2011, we reported that the DOD OIG issued a disclaimer of opinion on the Marine Corps' fiscal year 2010 SBR because the Marine Corps could not provide documentary support for transactions in a timely manner, and support for transactions was missing or incomplete.[15] We also reported that the Marine Corps experienced difficulty identifying and

[14]Under FIAR Guidance, an assessable unit can be any part of the financial statements, such as a line item or a class of assets or transactions (e.g., military equipment or civilian pay), or it can be a process or a system that helps produce the financial statements.

[15]GAO-11-830.

providing complete populations of transactions that the auditors could confirm and use as a basis for substantive testing.[16] In addition, the DOD OIG reported that the Marine Corps did not have adequate processes, systems, and controls over accounting for and reporting on the use of budgetary resources. Further, the Marine Corps could not provide evidence that reconciliations for key accounts and processes, such as the reconciliation (or matching) of payments (outlays) to bulk (estimated) obligations for shipments of household goods recorded in its Military Personnel appropriation account, were being performed.[17] The OIG reported that Marine Corps management had not asserted that all corrective actions from eight previously identified material weaknesses had been completed.[18] These weaknesses included, among others, deficiencies in financial management systems and deficiencies in controls over Fund Balance with Treasury[19] and unobligated balances.[20]

During its fiscal year 2011 SBR audit effort, the Marine Corps again experienced difficulty in identifying complete populations and providing supporting documentation for samples of transactions selected by the auditors for testing. In November 2011, the DOD OIG issued a disclaimer of opinion on the Marine Corps' fiscal year 2011 SBR, basically for the

[16]Testing of the reasonableness of account balances or amounts in financial statements is commonly referred to as substantive testing. This is in contrast to testing of the internal controls related to a particular account or balance.

[17]The Marine Corps estimates obligations in a bulk amount to record payment liabilities where it does not have a mechanism to identify authorizing documentation as a basis for recording the obligations, e.g., for individual shipments.

[18]A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

[19]In the federal government, an agency's Fund Balance with Treasury accounts are similar in concept to corporate bank accounts. The difference is that instead of a cash balance, Fund Balance with Treasury represents unexpended spending authority in appropriation accounts. Similar to bank accounts, the funds in DOD's appropriation accounts must be reduced or increased as the department spends money or receives collections that it is authorized to retain for its own use.

[20]Unobligated balances are amounts of appropriated funds that have not yet been recorded as an obligation, or legal liability, to make an immediate or future payment for goods or services.

same reasons as the fiscal year 2010 disclaimer.[21] However, based on discussions with DOD Comptroller, Navy, and Marine Corps officials after the audit report was issued, the OIG decided to give the Marine Corps additional time to provide audit documentation that had not been obtained during the original time frame of the audit. Consequently, on December 29, 2011, the OIG extended the audit of the Marine Corps' fiscal year 2011 SBR to March 31, 2012. Despite the extended testing period, the Marine Corps was still unable to provide timely and relevant supporting documentation necessary for completing audit procedures to determine whether the Marine Corps' fiscal year 2011 SBR was presented fairly. As a result, the DOD OIG's November 2011 disclaimer of opinion on the Marine Corps' fiscal year 2011 SBR was not amended. For fiscal year 2012, the DOD OIG continued as the auditor with responsibility for issuing the audit opinion and contracted with an audit firm for assistance in performing an audit of the Marine Corps' budgetary activity reported on a current year General Fund schedule, beginning with fiscal year 2012 appropriations.

Relationship of the Schedule of Budgetary Activity to the Statement of Budgetary Resources

The Marine Corps' fiscal year 2012 General Fund Schedule is an interim, DOD component-level special report intended to provide a building block to an SBR audit through audits of consecutive fiscal year schedules of budgetary activity.[22] The schedule of budgetary activity, like the SBR, is designed to provide information on budgeted spending authority as outlined in the President's Budget, including budgetary resources, availability of budgetary resources, and how obligated resources have been used. The SBR and the schedule of budgetary activity aggregate account-level information reported in the Standard Form (SF)-133, Report

[21]Department of Defense, Office of Inspector General, *Independent Auditor's Report on the United States Marine Corps General Fund FY 2011 and FY 2010 Combined Statement of Budgetary Resources*, DODIG-2012-016 (Alexandria, VA: Nov. 22, 2011).

[22]American Institute of Certified Public Accountants (AICPA), AU Section 623, *Special Reports*, paras. .11–.18, provides guidance on auditing elements of a financial statement, such as the Schedule of Budgetary Activity, that are presented in accordance with GAAP. The AICPA's Statements on Auditing Standards (SAS) are codified into audit sections, referred to as AUs.

on Budget Execution and Budgetary Resources,[23] and summarize budgetary data reported in the Program and Financing schedules in the subsequent President's Budget.[24] Both the SBR and the schedule of budgetary activity consist of four separate, but related, sections that provide information about budgetary resources, the status of budgetary resources, changes in obligated balances, and outlays for major budgetary accounts.[25] However, instead of covering the full range of SBR activity on current and expired appropriations that have not canceled, the first-year Schedule of Budgetary Activity covers only activity on current fiscal year appropriations. Subsequent fiscal year Schedules of Budgetary Activity would include activity in subsequent years' appropriations, building toward an SBR. For example, in the second year, the fiscal year 2013 Schedule of Budgetary Activity would include fiscal year 2013 budgetary activity related to fiscal year 2012 and 2013 appropriations.

Budgetary Resources. This section of a first-year schedule of budgetary activity shows total budgetary resources made available to the agency for obligation during the current fiscal year only.[26] It consists of new budget authority, reimbursements, and other income. The first-year schedule of budgetary activity does not include unobligated amounts from prior periods, commonly referred to as beginning balances. In contrast, the SBR includes unobligated amounts available from prior reporting periods; transfers available from prior year balances; and adjustments, such as recoveries of prior year obligations. In addition, the SBR includes all other information provided in this section of the schedule of budgetary activity.

[23]According to Office of Management and Budget Circular No. A-11, the SF-133 is intended to provide a consistent presentation of data across programs within each agency, and across agencies, which helps program, budget, and accounting staffs to communicate. SF-133s provide historical reference that can be used to help prepare the President's Budget, program operating plans, and spending estimates. The reports also provide a basis to determine obligation patterns when programs are required to operate under a continuing resolution. An agency-wide SF-133 should generally agree with an agency's SBR.

[24]In addition to presenting information on budgetary resources, their availability, and their use, Program and Financing schedules include information on budgetary resources by budget activities identified in the President's Budget.

[25]Outlays are payments, also referred to as disbursements or expenditures.

[26]An obligation is a definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received. Payment may be made immediately or in the future.

Status of Budgetary Resources. This section of the schedule of budgetary activity and the SBR displays the status of budgetary resources at the end of the period and consists of obligations incurred and the unobligated balances at the end of the period that are available for future use. For the schedule of budgetary activity and the SBR, the total for this section must agree with the total for the Budgetary Resources section described above, as this section describes the status of total budgetary resources. In addition to the current year activity, the SBR includes obligations that are unavailable except to adjust or liquidate obligations chargeable to prior period appropriations.

Change in Obligated Balance. This section of the schedule of budgetary activity consists of obligations incurred in the current year, less current year outlays. In addition to current year activity, the SBR would also include unpaid obligations brought forward from the prior years and recoveries of prior year unpaid obligations.

Outlays. This section shows the relationship between obligations and outlays (also referred to as disbursements or expenditures) and discloses the payments made to liquidate obligations. Obligations are usually liquidated by means of cash payments (outlays), such as currency, checks, or electronic fund transfers. This section reconciles outlays with obligations incurred and the change in obligated balances during the year. The content of this section is the same for the SBR and the schedule of budgetary activity.

Basis of Accounting

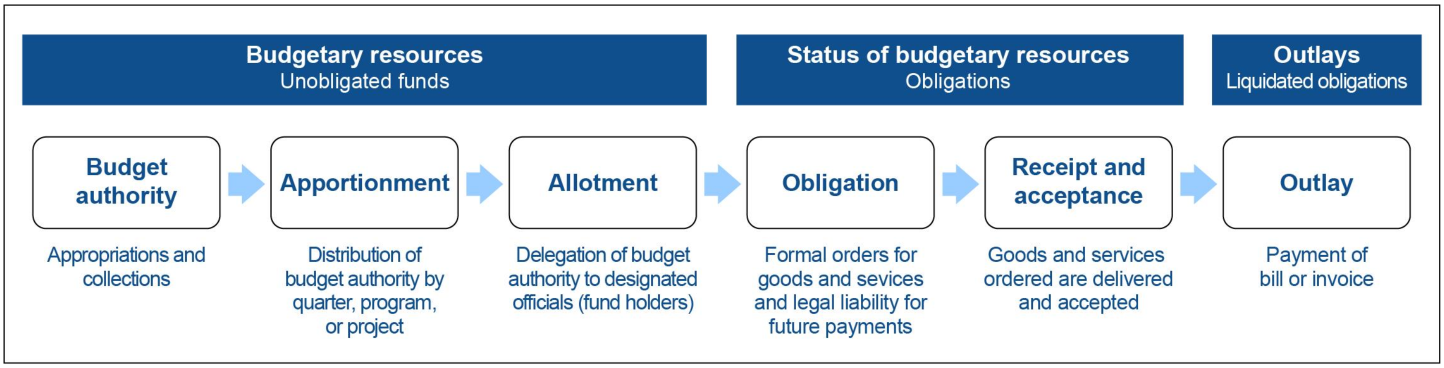
The Office of Management and Budget (OMB) requires federal government financial statements, including the SBR, to be presented in accordance with GAAP for the federal government. The Federal Accounting Standards Advisory Board (FASAB) establishes GAAP for federal governmental entities.[27] Federal government entities also are

[27]In October 1990, the Secretary of the Treasury, the Director of OMB, and the Comptroller General of the United States created FASAB to develop accounting standards and principles for the U.S. government. In October 1999, the AICPA designated FASAB as the board to establish GAAP for federal governmental entities. As such, FASAB is responsible for identifying the sources of accounting principles and providing federal entities with a framework for selecting the principles to be used in preparing general purpose financial reports that are presented in conformity with GAAP. See Statements of Federal Financial Accounting Standards No. 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, sections 1–5.

required to follow the *U.S. Standard General Ledger* (USSGL) Chart of Accounts, established by the Department of the Treasury (Treasury) for budgetary and proprietary accounting.[28] Budgetary accounts related to the SBR and schedule of budgetary activity are used to recognize and track budget approval and execution, whereas proprietary accounts are used to recognize and track assets and liabilities reported on the Balance Sheet and revenue and expenses reported on the Statement of Net Cost.

The USSGL accounts with the most significance to the Marine Corps' General Fund Schedule are those accounts related to budget authority, including Appropriations and Collections; Obligations for orders of goods and services; and Outlays, or cash payments for goods and services that have been delivered (received and accepted by the agency). Figure 2 shows the flow of budgetary resources from receipt of appropriations and collections through apportionment and allotment of funds, obligation of funds for orders of goods and services, and receipt and acceptance of goods and services to cash outlay or payment for the items received.

Figure 2: Flow of Budgetary Resources from Appropriation through Outlay



Source: GAO analysis. | GAO-15-198

[28]A general ledger is the master set of accounts that summarize all transactions occurring within an entity. The general ledger accounting system works as a central repository for accounting data transferred from all subsidiary ledgers, or accounting system modules, and includes budgetary and proprietary transactions. The general ledger contains a debit and credit entry for every transaction recorded within it, so that the total of all debit balances in the general ledger should always match the total of all credit balances.

Purpose, Objectives, and Conduct of a Financial Statement Audit

Audits provide essential accountability and transparency over government programs. The purpose of a financial statement audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects,[29] in accordance with an applicable financial reporting framework, which would include GAAP for the reporting entity.[30] An audit conducted in accordance with GAGAS enables the auditor to form that opinion, which enhances the degree of confidence that intended users can place on the financial statements. OMB requires that audits of federal financial statements be performed in accordance with GAGAS and OMB Bulletin 07-04.[31] For the federal government, OMB issues financial reporting requirements that are incorporated into GAAP and audit requirements for audits of federal financial statements that supplement GAGAS.[32] OMB guidance is particularly important because of the unique requirements related to the preparation of the SBR and the consolidation of the federal government's financial statements.

[29]AU Section 508, *Reports on Audited Financial Statements*, defines the three types of opinions as the auditor's standard report (commonly referred to as unqualified, qualified, and adverse). In reporting an unqualified opinion on the financial statements, the auditor concludes that the financial statements and accompanying notes present fairly, in all material respects, the entity's financial position as of the balance sheet date(s) and the net cost of operations, changes in net position, budgetary resources, and custodial activity (if applicable) for the fiscal years then ended in accordance with GAAP. A qualified opinion states that except for the effects of the matter to which the qualification relates, the financial statements are presented fairly, in all material respects, in accordance with GAAP. An adverse opinion states that the financial statements as a whole are not presented fairly in accordance with GAAP.

[30]The applicable financial reporting framework refers to the basis of accounting adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that are acceptable in view of the nature of the entity and the objective of the financial statements or the requirements of law or regulation. For DOD, the Schedule of Budgetary Activity is an approved Special Report in accordance with GAAP.

[31]Office of Management and Budget, *Audit Requirements for Federal Financial Statements*, OMB Bulletin No. 07-04, as amended by OMB Memorandum No. M-09-33 (Sept. 23, 2009). (See section 6.1.) This Bulletin was in effect for fiscal year 2012 statements but has since been superseded. *See* Office of Management and Budget, *Audit Requirements for Federal Financial Statements*, OMB Bulletin No. 14-02 (Oct. 21, 2013).

[32]Office of Management and Budget, *Financial Reporting Requirements*, OMB Circular No. A-136 (Aug. 3, 2012), and *Audit Requirements for Federal Financial Statements*, OMB Bulletin No. 07-04, as amended.

GAGAS provide a framework for performing high-quality audits with competence, integrity, objectivity, and independence to provide accountability and to help improve government operations and services.[33] For financial audits, GAGAS incorporate the American Institute of Certified Public Accountants (AICPA) fieldwork and reporting standards and the related Statements on Auditing Standards (SAS), unless specifically excluded or modified by GAGAS.[34] The SAS are codified into audit sections, referred to as AUs.

For this report, we generally refer to GAGAS and the specific, underlying AICPA standards, where appropriate. We also refer to the *Financial Audit Manual*, which is jointly approved and issued by GAO and federal agency inspectors general, for applicable audit guidance.[35] The *Financial Audit Manual* presents a methodology for performing financial statement audits of federal entities in accordance with professional standards.

As the basis for the auditor's opinion, GAGAS require the auditor to obtain reasonable assurance about whether the financial statements as a whole, or an element of the financial statements being audited in a Special Report, such as the Marine Corps' Fiscal Year 2012 General Fund Schedule, are free from material misstatement, whether due to fraud or error.[36] Reasonable assurance is a high, but not absolute, level of assurance that is reached when the auditor has obtained sufficient, appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements

[33]GAO, *Government Auditing Standards: July 2007 Revision*, GAO-07-731G (Washington, D.C.: July 2007).

[34]Founded in 1887, the AICPA is the national professional organization of certified public accountants in the United States. It sets ethical standards for the profession and U.S. auditing standards for audits of private companies; nonprofit organizations; and federal, state, and local governments.

[35]GAO and President's Council on Integrity and Efficiency, *Financial Audit Manual*, GAO-08-585G (Washington, D.C.: July 2008). The President's Council on Integrity and Efficiency was disestablished by the Inspector General Reform Act of 2008, Pub. L. No. 110-409, § 7 (Oct. 14, 2008), which instead established the Council of the Inspectors General on Integrity and Efficiency as an independent entity within the executive branch.

[36]A misstatement is a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with GAAP. Misstatements can arise from fraud or error.

are materially misstated) to an acceptably low level.[37] In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions that users make based on the financial statements. Judgments about materiality are made in light of surrounding circumstances and involve both qualitative and quantitative considerations.[38] These judgments are affected by the auditor's perception of the financial information needs of users of the financial statements, by the size or nature of a misstatement, or both. The auditor has no responsibility to obtain reasonable assurance that misstatements that are not material to the statements as a whole, whether caused by fraud or error, are detected.

Management is responsible for the fair presentation of financial statements that reflect the nature and operations of the entity. When undergoing an audit, management represents that the financial statements are fairly presented in conformity with GAAP. By doing so, management implicitly and explicitly makes assertions regarding the recognition, measurement, presentation, and disclosure of the information in the financial statements and related disclosures as a whole. In accordance with auditing standards, the auditor should assess the risk of material misstatement at the financial statement and relevant assertion levels, and design and perform audit procedures to reduce the risk of material misstatement to an acceptably low level. Auditing standards state that financial statement assertions used by the auditor about

[37] Sufficiency of evidence is the measure of the quantity of audit evidence. Appropriateness is a measure of the quality of audit evidence, that is, its relevance and its reliability in providing support for, or detecting misstatements in, the classes of transactions, account balances, and disclosures and related assertions. The quantity of audit evidence needed is affected by the risk of misstatement (the greater the risk, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less audit evidence that may be required). Accordingly, the sufficiency and appropriateness of audit evidence are interrelated. However, merely obtaining more audit evidence may not compensate if it is of a lower quality. (AU Section 326, *Audit Evidence*, para. .06.)

[38] GAO-08-585G. (See vol. 1, Glossary.)

classes of transactions and events for the period under audit fall into the following categories.[39]

- **Occurrence.** Transactions and events that have been recorded have occurred and pertain to the entity.[40]
- **Completeness.** All transactions that should have been recorded were recorded.
- **Accuracy.** Amounts and other data relating to recorded transactions and events have been recorded appropriately.
- **Cutoff.** Transactions and events have been recorded in the correct accounting period.
- **Classification.** Transactions and events have been recorded in the proper accounts. For the schedule of budgetary activity, this includes ensuring that transactions are recorded to the proper appropriation or fund.

In addition, federal agency management is responsible for establishing and maintaining internal controls to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with laws and regulations under the law commonly known as the Federal Managers' Financial Integrity Act (FMFIA).[41] FMFIA and OMB Circular No. A-123[42] require the head of each executive agency to annually report to the President and the Congress assurance statements, including assurance regarding the effectiveness of internal controls over financial reporting and, for designated large federal agencies like DOD, whether financial management systems conform to government-wide

[39]AU Section 326, *Audit Evidence*, para. .15; AU Section 312, *Audit Risk and Materiality in Conducting an Audit*, para. .19; and AU Section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, para. .03.

[40]In addition to assertions about transactions and events in the period audited, there are similar assertions about account balances at the end of a period. For budgetary balances, these assertions include existence (e.g., budgetary balances are valid and properly supported and comply with requirements in budgetary law) and completeness (e.g., all budgetary balances, such as unobligated balances and unpaid obligations that should have been recorded, are recorded in the proper period).

[41]31 U.S.C. § 3512(c), (d).

[42]Office of Management and Budget, *Management's Responsibility for Internal Control*, OMB Circular No. A-123, section VI (Dec. 21, 2004).

requirements mandated by the Federal Financial Management Improvement Act of 1996 (FFMIA).[43]

In conducting a financial audit, the auditor develops the audit plan; assesses internal controls; performs testing; forms conclusions based on the audit evidence obtained; and based on that evidence, issues an opinion or a disclaimer. These four areas of work are referred to as the four phases of an audit.

- In the planning phase, the auditor obtains an understanding of the audited entity's operating environment, including business processes and the related systems and controls; reviews financial activity related to significant financial statement line items and accounts; assesses the risk of material misstatement; and develops an audit strategy.[44] Planning continues throughout the audit as decisions are made about the risk of material misstatement and whether to perform additional procedures.
- During the internal control phase, the auditor identifies and tests key internal controls and information technology system controls as a basis for determining the extent to which the auditor will be able to rely on controls in conducting the audit.[45] Based on the information obtained during the planning and internal control phases, the auditor determines the nature, extent, and timing of substantive testing.[46] Depending on the extent to which controls can be relied on for assurance of fair presentation of the financial statements, the auditor will perform more or less substantive testing.[47]

[43]Pub. L. No. 104-208, div. A, title VIII, § 803, 110 Stat. 3009, 3009-390 (Sept. 30, 1996). DOD's financial management systems are required by FFMIA to comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the USSGL at the transaction level.

[44]AU Section 326, *Audit Evidence*, paras. .20 and .21, and AU Section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, paras. .102–.121.

[45]AU Section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, para. .40.

[46]Substantive procedures are performed to detect material misstatements and include detail tests of transactions, account balances and line items at the relevant assertion levels, and analytical procedures, such as comparisons of financial statement information with auditor expectations. (AU Section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, paras. .50–.54.)

[47]AU Section 326, *Audit Evidence*, para. .23.

- In the testing phase, the auditor performs substantive testing of detail support for transactions and may also perform analytical procedures. In accordance with AU Section 318, these substantive procedures are performed to detect material misstatements at the relevant assertion level and include tests of classes of transactions, account balances, and disclosures.[48]
- During the reporting phase, the auditor reviews the body of evidence obtained, reviews the conclusions reached about that evidence, and determines the materiality of uncorrected misstatements and untested amounts as a basis for forming an opinion.[49] Depending on issues identified during the audit, the auditor may decide to perform additional procedures to support a conclusion on the audit results.

The Audit of the Marine Corps' Fiscal Year 2012 Schedule of Budgetary Activity Did Not Obtain Sufficient, Appropriate Evidence to Support the Audit Opinion

Our review of the audit documentation supporting the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule identified key areas where sufficient audit procedures were not performed, under professional auditing standards, and consequently sufficient, appropriate evidence was not obtained to support the reported audit opinion. Specifically, the audit documentation does not provide evidence that the auditors had (1) performed sufficient procedures to determine the completeness of budgetary transactions reported on the Marine Corps' Fiscal Year 2012 General Fund Schedule, (2) performed sufficient procedures to determine the reliability of certain evidence used to support transactions included on the Marine Corps' Schedule, (3) performed sufficient procedures to determine whether budget activity was recorded in the proper period and shipment obligations were properly recorded, and (4) properly considered and evaluated the audit evidence in concluding and reporting on the audit results.

On March 23, 2015, the DOD OIG announced the withdrawal of its Auditor's Report on the Marine Corps' Fiscal Year 2012 General Fund Schedule. In a memorandum to DOD and Marine Corps leadership, the OIG's Deputy Inspector General for Auditing stated that subsequently discovered facts identified during the audit of the Marine Corps' Fiscal

[48]AU Section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, para. .50.

[49]AU Section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, paras. .74–.76, and AU Section 312, *Audit Risk and Materiality in Conducting and Audit*, paras. .50–.65.

Year 2014 General Fund Schedule caused the OIG to question the completeness of the information on which the OIG based its opinion. More specifically, the OIG reported that (1) suspense accounts, which the U.S. Treasury maintains and which are used to temporarily hold transactions that could not be posted to a valid appropriation, contained Marine Corps transactions; (2) it believes that this condition existed in fiscal year 2012; and (3) it was unable to determine whether such transactions were material in relation to the Marine Corps' Fiscal Year 2012 General Fund Schedule. Marine Corps transactions recorded to suspense accounts would not have been recorded in the Marine Corps' Fiscal Year 2012 Schedule. At that time, the OIG indicated that once additional information has been gathered and analyzed, the fiscal year 2012 audit opinion will be revised in light of its analysis and reissued. In commenting on our report, the OIG stated that it would consider all relevant information, including the findings and recommendations in our report, the findings of the four ongoing audits of suspense accounts, and a report from the OIG's Quality and Standards Office before deciding whether to reissue an opinion on the Marine Corps' Fiscal year 2012 General Fund Schedule.

The OIG's Procedures to Determine Completeness of Budgetary Transactions Were Insufficient

Auditing standards require, among other things, that the auditor (1) assess the risk of material misstatement at the relevant assertion level[50] and (2) perform substantive procedures for all relevant assertions related to material classes of transactions, account balances and disclosures.[51] Auditing standards further state that existence and completeness are always relevant assertions.[52] Testing for completeness may be performed in a number of ways, including the following:

- **Tests of detail transactions.** When testing detail transactions for the completeness assertion, the auditor should select from audit evidence indicating that an item should be included in the relevant financial statement amount and should investigate whether the item is so

[50]AU Section 312, *Audit Risk and Materiality in Conducting an Audit*, para. .23.

[51]AU Section 312, *Audit Risk and Materiality in Conducting an Audit*, para. .25.

[52]AU Section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, para. .01.

included.[53] For example, the auditor would select from data sources outside or independent of the amounts being tested.

- **Reconciliations.** In performing a reconciliation, the auditor reconciles two populations and tests reconciling items to determine whether the two populations are consistent. For example, reconciliation would provide evidence that the transactions recorded in one population, in the aggregate, were also recorded in the other population.

We noted several areas where there is a high risk of material misstatement related to the completeness of outlays and obligations reported on the Marine Corps' Fiscal Year 2012 General Fund Schedule, for which the auditor either did not perform any testing procedures or did not perform sufficient procedures to determine whether there were material misstatements.[54] Specifically, there is a high risk of material misstatement that nonpayroll transactions recorded in feeder systems may not be reported in the Marine Corps' general ledger system—the Standard Accounting, Budgeting, and Reporting System (SABRS)—and transactions recorded in the current year may be improperly recorded to appropriations not included in the Marine Corps' Fiscal Year 2012 General Fund Schedule.

Figure 3 shows the business system data flow from the feeder systems through the Defense Cash and Accountability System (DCAS)[55] to the Marine Corps' SABRS general ledger system and through the Defense Departmental Reporting Systems (DDRS) to financial statements and the schedules of budgetary activity.[56]

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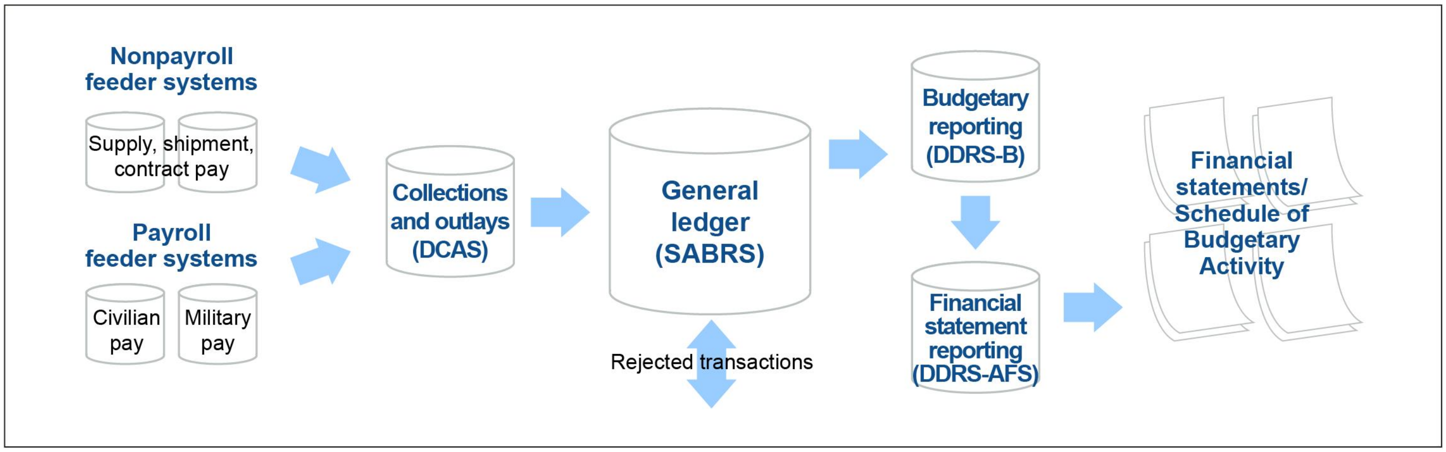
[53]AU Section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, para. .56.

[54]When the auditor assesses the risk of material misstatement as high, the auditor believes that controls will more unlikely than likely prevent or detect any aggregate misstatements that could occur in the assertion in excess of the materiality threshold established for concluding on the audit. (See GAO-08-585G, section 370.09.)

[55]DCAS is a data warehouse that performs certain edit checks and passes disbursement (outlay) and collection transactions to the Marine Corps' SABRS general ledger system. DCAS also serves as a repository of disbursement and collection transactions. DCAS reports monthly disbursement and collection transactions in SABRS to Treasury as part of the Fund Balance with Treasury reconciliation process.

[56]DDRS is a DOD-wide financial reporting system. DDRS-Budgetary (DDRS-B) generates budgetary reports, including monthly status of funds reports and SF-133, Reports on Budget Execution and Budgetary Resources. DDRS-Audited Financial Statements (DDRS-AFS) generates DOD's financial Statements.

Figure 3: Feeder System Data Flow through the Marine Corps' General Ledger for Financial Statement Reporting Purposes



DCAS: Defense Cash and Accountability System
DDRS-B: Defense Departmental Reporting System - Budgetary
DDRS-AFS: Defense Departmental Reporting System - Audited Financial Statements
SABRS: Standard Accounting, Budgeting, and Reporting System

Source: GAO analysis. | GAO-15-198

Feeder System Transactions

The Marine Corps has reported that over 90 percent of the financial transactions in SABRS originate in feeder systems and that it has 25 primary feeder systems.[57] Typical tests for completeness might include (1) tracing of samples of transactions from significant feeder systems to ensure that the transactions were recorded in SABRS; (2) reconciling feeder system data to transactions in SABRS; and (3) confirming that rejected feeder system transactions were properly identified, isolated, and corrected in a timely manner. The audit documentation shows that the audit team reconciled the transfer of fiscal year 2012 civilian and military payroll data from the related payroll systems to SABRS and concluded that the military and civilian payroll populations in SABRS were sufficiently complete.[58] However, the audit documentation does not

[57]United States Marine Corps, *2012 Financial Report: Schedule of Budgetary Activity for Fiscal Year 2012 Appropriations* (Dec. 20, 2013). In addition to the 25 primary business systems (referred to as Tier 1 systems) that feed data to its SABRS general ledger system, the Marine Corps reported that it has numerous Tier 2 and Tier 3 systems that feed data sequentially to the Tier 1 systems.

[58]Civilian payroll data are transferred to SABRS from the Defense Civilian Payroll System and military payroll data are transferred to SABRS from the Marine Corps Total Force System.

include audit procedures to test the completeness of fiscal year 2012 nonpayroll feeder system data recorded in SABRS.

The risk of material misstatement in the Marine Corps' Fiscal Year 2012 General Fund Schedule related to the transfer of transactions from nonpayroll feeder systems is high, we believe, based on the following conditions:

- Nonpayroll feeder system transactions were material, accounting for about half of the Marine Corps' reported fiscal year 2012 budgetary activity.[59]
- We identified examples of feeder system transactions that were not included in SABRS or were not included in SABRS on a timely basis.
- The Marine Corps did not have adequate processes for determining whether all transactions in the nonpayroll feeder systems were included in SABRS.
- There were reported internal control weaknesses that prevented the Marine Corps from reasonably assuring that all transactions in nonpayroll feeder systems were recorded in SABRS. For example, 11 of the Marine Corps' open recommendations were related to weaknesses in controls over transfers of feeder system data to SABRS. Open Marine Corps' recommendations, discussed later in this report, addressed actions to (1) assure the completeness of populations of transactions and account balances, (2) test interface controls between various feeder systems and the Marine Corps' SABRS general ledger system, and (3) perform reconciliations of feeder system data to SABRS.
- There were a significant number of rejected transactions. For example, the audit documentation related to the Marine Corps' corrective actions on data transfers to SABRS included examples of daily reports of rejected feeder system transactions covering the months of April through July of 2012, each of which listed thousands of transactions that were rejected by SABRS. Our analysis of the rejected transactions determined that 70 percent of these transactions related to significant Marine Corps nonpayroll-related feeder systems involved with supply order and shipment transactions. In addition, the

[59]The Marine Corps' nonpayroll feeder system data consist of contractor and vendor payments, travel, shipment, and supply and equipment purchase transactions originating in various DOD component agency systems.

Marine Corps did not have a formal policy and control procedure for correcting errors that occur during data interface processing.

- DOD's November 2013 FIAR Status Report,[60] issued 1 month prior to the OIG's audit report on the Marine Corps' Fiscal Year 2012 General Fund Schedule, showed that most Statement on Standards for Attestation Engagements (SSAE) No. 16 examinations of the effectiveness of controls over key DOD business feeder systems had not been completed,[61] raising questions about the completeness and the integrity of the processes and underlying data residing in these systems.

With regard to the completeness of transaction data in SABRS, members of the audit team told us that they had performed certain other tests. First, the team indicated, and the audit documentation showed, that it traced data from SABRS through the financial reporting process to the Marine Corps' Fiscal Year 2012 General Fund Schedule. As described in the audit documentation, this procedure would help confirm that data were not lost in processing from the general ledger to the Marine Corps' Fiscal Year 2012 General Fund Schedule. However, it does not provide evidence concerning the completeness of the data residing in SABRS, most of which originate in business systems outside of SABRS.

Second, members of the audit team told us that they traced the Marine Corps' SABRS general ledger system transaction data to transactions included in the Marine Corps' Fund Balance with Treasury reconciliation process and did not identify any missing transactions.[62] However, these procedures would not be effective for testing completeness of transactions recorded in SABRS because they begin with items that are already recorded in SABRS. Further, the audit documentation does not include evidence of a complete comparison of fiscal year 2012 SABRS transaction activity to fiscal year 2012 Fund Balance with Treasury

[60]Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, *Financial Improvement and Audit Readiness (FIAR) Plan Status Report* (November 2013).

[61]Such examinations are performed under the AICPA's SSAE No. 16, *Reporting on Controls at a Service Organization*, which provides guidance to service auditors for performing examinations to report on controls at organizations that provide services to user entities when those controls are likely to be relevant to user entities' internal control over financial reporting.

[62]The reconciliation process compares the agency's records to Treasury's records and resolves or adjusts for differences, similar to reconciling a corporate checking account balance to a bank statement.

reconciliations. For example, the audit documentation did not include a review of Marine Corps transactions submitted to Treasury by other federal agencies and other DOD components, such as the Army and U.S. Transportation Command, to determine whether they were properly recorded in SABRS.[63]

Transactions Rejected during Transfers to SABRS

One reason that feeder system transactions may not be recorded in SABRS relates to rejected transactions. According to Defense Finance and Accounting Service (DFAS) officials, transactions originating in feeder and other systems that cannot be posted to a valid appropriation are rejected and temporarily held by the Marine Corps for research, and if not resolved within the month, are recorded to suspense accounts until they are investigated, resolved, and correctly recorded. Any Marine Corps budgetary transactions that were included in suspense accounts at the end of fiscal year 2012 were not included in the Marine Corps' Fiscal Year 2012 General Fund Schedule.[64] As noted earlier, in late March 2015, the OIG withdrew its opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule because it was unable to determine whether transactions recorded in suspense accounts maintained by Treasury that were not included in the Marine Corps' Schedule were material to the Schedule.

As discussed later in this report, the Marine Corps had not yet addressed all information technology system recommendations from its fiscal years 2010 and 2011 SBR audits related to control weaknesses over data transfers between feeder systems and SABRS. One such recommendation relates to the lack of a formal policy and control procedure for correcting errors that occur during data interface processing, in which transactions flow from feeder systems through DCAS and ultimately into SABRS. Such a policy would help assure that identified errors and rejected transactions are reviewed by management, resolved, and resubmitted for processing. The audit documentation on the

[63]U.S. Transportation Command is a unified functional DOD combatant command that provides global mobility support (movement of personnel and items) to the military services, defense agencies, and other government organizations.

[64]According to DFAS's Standard Operating Procedures for Suspense Accounts, transactions that cannot be identified to a valid appropriation account are recorded to a DOD agency suspense account and transactions that cannot be identified to a valid receiving agency are recorded to a Treasury suspense account. (See Defense Finance and Accounting Service, Office of the Director, Corporate Accounting, *Standards and Compliance (S&C) Standard Operating Procedures for Use of Suspense Accounts F3875 and F3885* (March 2011).

Marine Corps' corrective actions for this recommendation shows that the Marine Corps took action to develop a report to monitor system rejects. However, the audit documentation used to support closing this recommendation does not include evidence that the auditors, in closing the recommendation, had performed procedures to (1) determine the causes of the rejected transactions as a basis for determining if appropriate corrective actions had been designed and implemented or (2) confirm that rejected feeder system transactions were properly resolved.

If audit procedures to confirm the completeness of transfers of nonpayroll feeder system data to SABRS are not sufficient, there may be undetected material amounts of transactions that are not properly included in the Marine Corps' Fiscal Year 2012 General Fund Schedule. Further, (1) populations used for substantive testing throughout the audit may not be complete, (2) sample sizes may not be appropriate, and (3) statistical tests may not be reliable for concluding on the results of the audit.

Transactions Recorded in Fiscal Year 2012 to Prior Year Appropriations

Another risk related to completeness is the risk that transactions recorded in fiscal year 2012 to prior year appropriations, which are excluded from the Marine Corps' Fiscal Year 2012 General Fund Schedule, should have been charged to 2012 appropriations included in the Schedule. The Marine Corps' Fiscal Year 2012 General Fund Schedule is represented to include only budgetary transactions recorded to fiscal year 2012 current appropriations. Typical tests for completeness of the general ledger with respect to such transactions would include examining appropriate evidence that samples of fiscal year 2012 budgetary transactions charged to prior year appropriations were properly charged to such prior year appropriations.

The audit documentation and discussions with the audit team did not disclose any testing of transactions related to fiscal year 2012 activity recorded to fiscal year 2011 and prior appropriations to determine whether there was evidence that such transactions should have been recorded to fiscal year 2012 appropriations. However, we believe the risk of material misstatement to the Marine Corps' Fiscal Year 2012 General Fund Schedule related to transactions recorded in fiscal year 2012 to prior year appropriations that should have been charged to fiscal year 2012 appropriations is high based on numerous reported Marine Corps' weaknesses in controls over accounting and financial reporting and the magnitude of fiscal year 2012 Marine Corps' outlays that were recorded to prior fiscal year appropriations. For example, Treasury's *Combined Statement of Receipts, Outlays, and Balances, Fiscal Year 2012* includes data on federal agency fiscal year 2012 outlays that were recorded to prior fiscal year appropriation accounts.[65] Our review of the reported Marine Corps' fiscal year 2012 outlay activity determined that over $3.8 billion in such outlay activity was recorded to fiscal year 2011 appropriations.

Despite these reported conditions, there was no evidence in the audit documentation that the OIG assessed the risk of material misstatement associated with fiscal year 2012 appropriation activity being improperly recorded in a prior fiscal year appropriation account, and no evidence that the OIG performed tests for completeness with respect to fiscal year 2012 appropriation transactions that may be improperly recorded in prior year appropriations. In response to our concern, the OIG stated that the scope of its audit only covered fiscal year 2012 current activity. As such, fiscal year 2011 or prior activity would not be in the scope of the audit. However, absent testing to identify fiscal year 2012 transactions improperly recorded to fiscal year 2011 and prior appropriations, there may be material budgetary transactions that were improperly excluded from the Marine Corps' Fiscal Year 2012 General Fund Schedule.

The OIG Did Not Perform Sufficient Procedures to Determine the Reliability of Certain Evidence Used in Transaction Testing

Testing of detail transactions is a basic audit test designed to determine whether the recorded transactions are supported by sufficient, appropriate evidence. It involves comparing recorded information to supporting documents to determine whether the transaction is valid (authorized and approved) and is recorded in the proper period, to the proper appropriation, and at the proper amount. For example, if the sampled transaction is an outlay for an item purchased, the auditor would review documents, such as the original purchase order, invoice, receiving report, and payment voucher, to substantiate the validity and amount of the sampled transaction.

In some instances, the auditor may be unable to obtain sufficient, appropriate evidence to support a selected transaction. In such cases, the auditor should perform alternative procedures to determine whether the transaction was properly supported. For example, the auditor may confirm the details of the transaction with a third party. If the auditor is unable to

[65]Department of the Treasury, Financial Management Service, *Combined Statement of Receipts, Outlays, and Balances, Fiscal Year 2012* (Washington, D.C.: Dec. 3, 2012).

obtain sufficient, appropriate evidence from alternative procedures, such items are generally treated as misstatements and are accumulated to determine whether such unsupported amounts are material in the aggregate.

In examining evidence supporting a transaction, the auditor should consider the reliability of the information to be used as audit evidence, such as electronic documents, including consideration of controls over their preparation and maintenance where relevant.[66] Such consideration would normally include any information that raises doubts about the reliability of the evidence. Also, when the auditor uses information produced by the entity to perform audit procedures, the auditor should obtain audit evidence about the accuracy and completeness of the information, for example, by performing procedures to determine whether the related controls over the data are effective.[67]

Auditing standards also state that the reliability of audit evidence is influenced by its source and by its nature and is dependent on the individual circumstances under which it is obtained.[68] Even when audit evidence is obtained from sources external to the entity, circumstances may exist that could affect the reliability of the information obtained. For example, audit evidence obtained from an independent external source may not be reliable if the source is not knowledgeable. This means that regardless of the source of the information, if the auditor has doubts about the reliability of information to be used as audit evidence or is aware of problems with the reliability of the data, the auditor should determine what modifications or additions to audit procedures are necessary to resolve the issues.

The audit documentation shows that the auditors had requested appropriate transaction documents from the Marine Corps, including orders, receiving reports, and invoices. However, the audit documentation also shows that when the Marine Corps was unable to provide the requested documents for a selected transaction, the auditors relied on

[66]AU Section 326, *Audit Evidence*, para. .09.

[67]AU Section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, para. .14, and AU Section 326, *Audit Evidence*, para. .10.

[68]AU Section 326, *Audit Evidence*, para. .08.

data generated from other DOD agencies that provided goods or services as evidence to support the transaction.[69] However, the auditors did not document their consideration of the reliability of the evidence provided from these other DOD agencies, although there was evidence that should have raised doubts about its reliability. In addition, the auditors relied on support produced from certain Marine Corps systems without obtaining sufficient evidence about the accuracy and completeness of the information.

The following examples describe well-known, documented issues related to certain DOD systems that, in our view, raise significant doubts about the reliability of data from those processes and systems that the OIG relied on in its transaction testing.

- DOD reported the Defense Logistics Agency's (DLA)[70] Military Standard Requisitioning and Issues Procedures (MILSTRIP) as a department-wide material weakness in its fiscal year 2012 agency financial report,[71] stating that the department could not effectively account for transactions and balances in the MILSTRIP orders process. DOD's reported target date for completing corrective actions was 2014.
- U.S. Transportation Command had not yet asserted audit readiness, and it had not undergone an SSAE No. 16 examination as of the end of fiscal year 2012. Further, U.S. Transportation Command uses the Defense Enterprise Accounting and Management System (DEAMS) as its official billing system, and DEAMS had not yet undergone

[69]Various DOD agencies perform business or mission-related services (such as providing accounting, supply, and shipment services) to the Marine Corps, the other military services, and DOD agencies. These service agencies also generate financial transaction information related to billings for those business services.

[70]DLA acquires and provides the military services nearly 100 percent of the consumable items they need to operate, including food, fuel and energy, uniforms, medical supplies, and about 85 percent of the military's spare parts. DLA also coordinates with U.S. Transportation Command on the shipment of supply and equipment orders to the military services.

[71]Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, *Department of Defense Agency Financial Report, Fiscal Year 2012*, Addendum A, (Washington, D.C.: Nov. 15, 2012). (See A-34 and A-39.)

testing of its financial reporting controls.[72] However, the DOD OIG had previously reported that DEAMS managers did not maintain an adequate general ledger chart of accounts and that DEAMS managers did not take the steps needed to ensure that DEAMS had the capability to record and track transaction data.[73] As a result, instead of properly recording transactions, such as budget authority, obligations, collections, and disbursements (outlays) at the time of the related events, DEAMS managers relied on DFAS to record journal vouchers (adjusting entries) in DDRS and used other offline electronic processes, such as spreadsheets, to record accounting entries. According to the DOD OIG, because funds control accounting was not being managed in DEAMS, budget execution reports and SBRs were developed using budgetary status data that could not be traced to actual transaction data within the official accounting system. These weaknesses increase the risk of accounting, billing, and financial reporting errors.

- In disclaiming an opinion on DOD's department-wide financial statements for fiscal year 2012, the OIG reported that DOD financial management and business feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2012.[74] The OIG also reported that financial systems did not comply with FFMIA. DOD continued to report that the vast majority of the information needed to prepare the department's financial statements originates in feeder systems that input data into its financial systems and that the effectiveness of controls over most feeder systems has not been tested to determine whether information in such systems is reliable.

These data integrity issues should have raised significant doubts about the reliability of the information used as evidence to support some of the Marine Corps' transactions, and should have triggered an assessment of

[72]DEAMS is a financial management enterprise resource planning (ERP) system initiative by the Air Force, U.S. Transportation Command, and DFAS. Its purpose is to support the warfighter with timely, accurate, and reliable financial information to enable efficient and effective decision making.

[73]Department of Defense, Office of Inspector General, *An Unreliable Chart of Accounts Affected Auditability of Defense Enterprise Accounting and Management System Financial Data*, DODIG-2012-140 (Alexandria, VA: Sept. 28, 2012).

[74]Department of Defense, Office of Inspector General, *Independent Auditor's Report on the Department of Defense FY 2012 and FY 2011 Financial Statements*, DODIG-2013-021 (Alexandria, VA: Nov. 15, 2012).

the evidence to determine if it was sufficiently reliable to support the selected transactions. In addition, the auditors should obtain evidence of the accuracy and completeness of audit evidence produced by Marine Corps systems that they rely on for audit testing. If the evidence is not sufficiently reliable, the related amounts recorded in the Marine Corps' Fiscal Year 2012 General Fund Schedule should be considered misstatements and evaluated to determine whether such inadequately supported transactions are material.

Our review of the audit documentation for sample outlay transactions that the auditors indicated were properly supported by sufficient, appropriate evidence identified numerous instances where the auditors relied on data from certain Marine Corps and other DOD agency business systems and processes with data reliability issues. We were unable to determine the full extent of transactions supported by such evidence because the support for transaction samples that passed the auditor's tests (i.e., were not identified as exceptions) was not always readily available.[75] However, our review of the audit documentation identified the following examples of outlay transactions selected for substantive detail testing that were supported solely by data generated from these DOD business systems and processes.

- When the Marine Corps could not provide original support for sample military supply order transactions, the audit firm relied on data from feeder systems and business processes with data reliability issues. These systems included the Marine Corps' Supported Activities Supply System (SASSY)[76] and other Defense agency business systems, including systems involved with DLA's MILSTRIP business process. Our review of the OIG's audit documentation for 257 outlay sample items that were retested by the OIG as part of its oversight of the audit firm's substantive tests of Marine Corps outlays found that at

[75]Auditing standards do not require that documentation for tested transactions that were deemed to be without exception be retained in the official audit documentation.

[76]The Marine Corps initiated action to phase out SASSY in July 2011 and began transferring supply order functions to GCSS-MC. While the phase-out of SASSY was ongoing as of December 2013 when the auditor's report on the Marine Corps' Fiscal Year 2012 General Fund Schedule was issued, processes and controls related to SASSY had not been audited and the GCSS-MC *Federal Information System Controls Audit Manual (FISCAM)* audit had identified significant weaknesses in general system controls. (GAO, *Federal Information System Controls Audit Manual (FISCAM)*, GAO-09-232G (Washington, D.C.: February 2009).)

least 42 of the 257 supply order outlay sample items (16 percent) shown as tested without exception were supported solely by data generated directly from such DOD systems and processes.[77] As discussed later, OIG management accepted the same type of feeder systems data as sole support for 13 DLA MILSTRIP transactions and 1 U.S. Transportation Command shipment transaction in control tests for proper cutoff on fiscal year 2012 outlays.

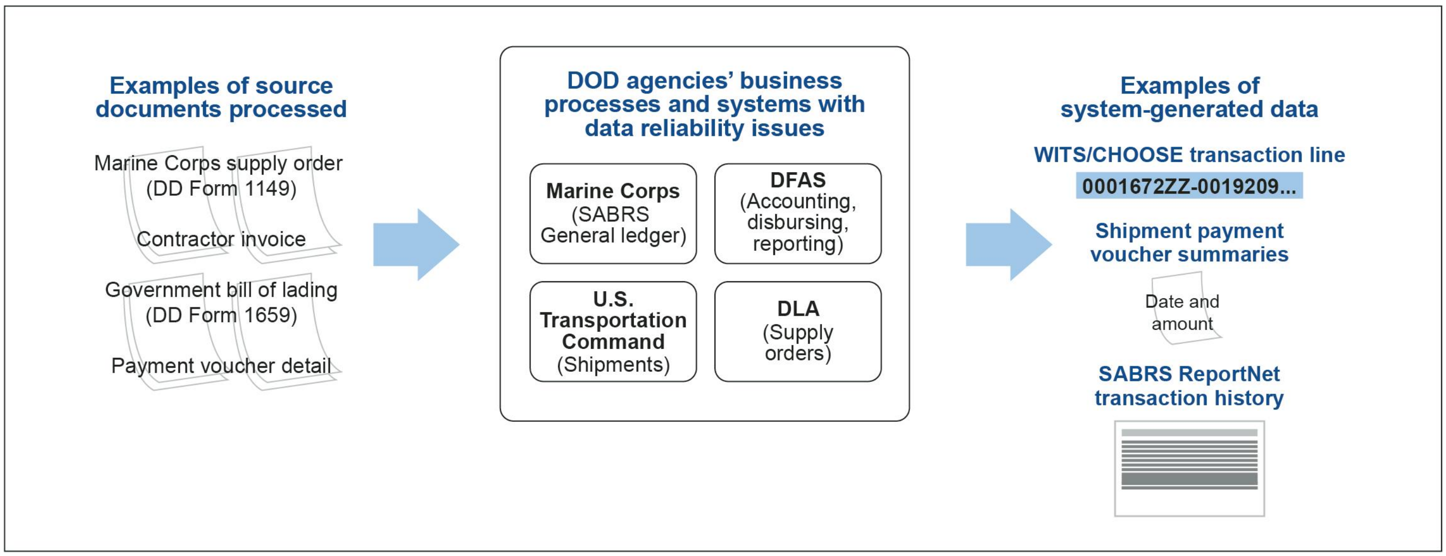
- Audit documentation on the results of substantive testing of 94 outlay sample items related to U.S. Transportation Command shipments of military supplies and equipment and shipments of household goods showed that 72 of the 94 shipment outlay sample items (77 percent) were supported solely by consolidated Interfund billings generated by U.S. Transportation Command systems. Interfund billings are transfers of funds between federal agency appropriations that are processed through Treasury's Intergovernmental Payment and Collection (IPAC) system. [78] Marine Corps Interfund billings included coded accounting lines for multiple transactions, generally without any of the original supporting documentation for the individual transactions. According to the audit documentation, the auditors concluded that 71 of the 72 outlay sample items were tested without exception. The one exception was a sample item for a fiscal year 2011 shipment that the auditors believed was outside the scope of the Marine Corps' fiscal year 2012 audit and thus recorded an exception.

[77]Defense agency business systems and processes with data reliability issues included WITS and CHOOSE. The Web Interfund Transaction Search (WITS) is an Internet-based research tool developed by DFAS and the Defense Enterprise Computing Center-Mechanicsburg that enables users to access a database, located on a web server, that contains Navy and Marine Corps Interfund billings and allows the user to create various reports based on the user's search criteria and reporting needs. Interfund billings (or fund transfers) are similar to reimbursement transactions between different federal agencies' fund accounts. The Cash History On-Line Operator Search Engine (CHOOSE) is a database that DFAS-Cleveland uses to research disbursement transactions (outlays).

[78]IPAC is a U.S. Treasury system that provides a way for federal agencies to transfer funds from one agency to another with standardized descriptive data. DOD agencies use IPAC to execute billing and collection transactions (also referred to as Interfund transactions) between DOD agency appropriations. U.S. Transportation Command Interfund IPAC billings are generated by the U.S. Transportation Command accounting system related to a specific shipment process, such as air, land, or sea, or commercial carrier, and are reported on journal vouchers for transfers from the associated fiscal year 2012 Marine Corps appropriation account to U.S. Transportation Command's Working Capital Fund account. A Working Capital Fund is a type of intragovernmental revolving fund that operates as a self-supporting entity that conducts a regular cycle of businesslike activities. These funds function entirely from the fees charged for the services they provide consistent with their statutory authority.

Figure 4 shows examples of source documents used in DLA's MILSTRIP and U.S. Transportation Command's shipment processes compared with the types of DOD system-generated data that the auditors relied on when the Marine Corps could not locate and provide the original transaction documentation to the auditors.

Figure 4: Comparison of Original Source Documents Used for Recording Transactions with System-Generated Documentation Used in Auditor Testing



CHOOSE: Cash History On-Line Operator Search Engine
DD: Defense Department
DFAS: Defense Finance and Accounting Service
DLA: Defense Logistics Agency
SABRS: Standard Accounting, Budgeting, and Reporting System
WITS: Web Interfund Transaction Search

Source: GAO analysis. | GAO-15-198

The data reliability issues related to these systems should have been identified in the auditor's assessment of the risk of material misstatement, and appropriate audit procedures should have been performed to assess the reliability of such evidence and to determine the accuracy and completeness of evidence produced by Marine Corps' systems. Absent performing sufficient procedures to assess the reliability of such information, there is insufficient evidence to support the accuracy and completeness of transactions that are based solely on this evidence.

Audit Procedures Were Not Sufficient to Determine Whether Budget Activity Was Recorded in the Proper Period and Whether Shipment Obligations Were Properly Recorded

The OIG's audit documentation did not contain evidence of sufficient procedures for fiscal year 2012 cutoff testing and testing of shipment obligations.

Scope of Cutoff Testing Was Not Adequate to Assure Obligations and Outlays Were Recorded in the Proper Period

As noted previously, cutoff is one of the financial statement assertions that the auditor considers during a financial statement audit. The cutoff assertion relates to whether transactions and events have been recorded in the correct accounting period. Cutoff includes consideration of two aspects. The first aspect, which relates to the existence or occurrence assertion, is that all transactions recorded in the current period relate to the current period. The second aspect, which relates to the completeness assertion, is that all transactions that should have been recorded in the current period have been recorded in the current period and are properly included in the financial statements.

Although the OIG performed certain cutoff testing, our review of the audit documentation and discussions with the OIG determined that certain risks of material misstatement related to cutoff were not identified and addressed. The length of the cutoff period tested was not based on a complete assessment of the risk of material misstatement. Further, the auditors did not consider the lengthy transaction cycle for certain transactions that pose a higher risk of transactions being recorded to the wrong fiscal year appropriation. Specifically:

- No cutoff testing procedures were performed related to the risk that fiscal year 2012 transactions may have been recorded improperly as fiscal year 2011 activity.
- Given the lag time in properly recording certain types of transactions, risk exists that fiscal year 2012 transactions that were recorded after the cutoff period, or that certain types of transactions recorded during the end-of-year cutoff period, could be improperly charged to fiscal year 2013 appropriations.

Because of these risks and uncorrected Marine Corps accounting and financial reporting weaknesses, the risk of material misstatement was high and additional procedures should have been performed to determine whether budgetary activity related to fiscal year 2012 appropriations was recorded in the proper period. Further, because such additional cutoff procedures were not performed, there may be material transactions related to fiscal year 2012 appropriations that were not properly recorded in the Marine Corps' Fiscal Year 2012 General Fund Schedule.

The objective of cutoff testing is to obtain evidence about whether transactions were recorded in the proper accounting period. Cutoff tests, intended to test for completeness, determine whether transactions recorded prior to the fiscal year or after the end of the fiscal year should have been included in the year being audited. As previously discussed, the Marine Corps' Fiscal Year 2012 General Fund Schedule was intended to cover current year activity on fiscal year 2012 appropriations. Typical cutoff tests for completeness include testing transactions recorded before the beginning of the reporting period and after the end of the reporting period to determine whether there are material amounts of transactions that should have been recorded in the current reporting period. Obtaining sufficient evidence of proper cutoff may also necessitate that the auditor perform other procedures. For example, if there is a risk that transactions may be recorded after the cutoff testing period or the audit completion date, such procedures may include examining open purchase orders, unpaid invoices, and contracts as of a date near the audit completion date,[79] or estimating amounts that should be recorded in the current year based on appropriate evidence.

To assess the risk of material misstatement related to cutoff and determine the scope of cutoff testing with respect to budgetary activity, auditors would generally determine the length of transaction cycles from when a transaction occurs to when the transaction is properly recorded for significant business processes.[80] Certain business processes may have short cycle times. For example, the transaction cycle for payroll is typically fairly short. For business processes with long cycle times, such as certain types of shipment transactions, obligations made in the last quarter of a fiscal year may not be recorded until the first month or the first quarter in the next fiscal year, or until the outlay is made, which could be several months into the next fiscal year. In such instances, obligations and outlays may not be recorded to the proper accounting period,

[79]GAO and President's Council on Integrity and Efficiency, *Financial Audit Manual*, GAO-08-585G. (See section 495B.03.)

[80]Also, see AU Section 326, *Audit Evidence*, paras. .19–.22.

particularly if subsequent adjustments were not recorded timely. Accordingly, as shown in figure 5, depending on the entity's transaction cycle times and level of assessed risk of material misstatement, the auditor would plan cutoff testing that considers the length of significant transaction cycles with regard to the beginning and end of the accounting period audited.

Figure 5: Timeline for Cutoff Testing for a 1-Year Schedule of Budgetary Activity

Source: GAO analysis. | GAO-15-198

Auditing standards provide detailed guidance on obtaining an understanding of the entity and its environment to (1) assess the risks of material misstatement at the financial statement and relevant assertion levels and identify risks by classes of transactions;[81] account balances, and disclosures in the financial statements; (2) relate the risks to what could go wrong at the relevant assertion level; and (3) consider the significance and likelihood of material misstatement for each identified risk in order to design appropriate substantive tests.[82]

Assessment of Risks of Material Misstatement Related to Cutoff Was Not Sufficiently Documented

As noted above, the auditor should assess the risk of material misstatement related to relevant assertions. In this case, the OIG identified proper cutoff as a risk of material misstatement. We agree with the OIG's identification of cutoff as having a risk of material misstatement. Our assessment included consideration of the following factors that we believe result in a high risk of material misstatement related to cutoff.

[81] Examples of classes of transactions include obligations and outlays.

[82] AU Section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, para. .102, and AU Section 326, *Audit Evidence*, paras. .20a and .21.

- There are identified examples of transactions being recorded in the wrong period—DOD reports of Antideficiency Act violations[83] provided to GAO identified numerous DOD-wide instances of transactions that were recorded to the wrong period.[84] DOD has also reported a violation of the act related to a late U.S. Transportation Command shipment billing that was recorded in the subsequent fiscal year. When the need for an adjustment was identified, funds allocated for shipments in the previous fiscal year had been exhausted. In addition, we previously reported that the Marine Corps' use of bulk estimated obligations for shipments of household goods related to permanent change-of-station moves that generally take 2 or more fiscal years to fully liquidate (i.e., for the final payment or outlays to be made) poses a risk of Antideficiency Act violations if the estimated obligations are too low and outlays exceed the bulk obligation.[85] The Army, the Navy, and the Air Force have each reported violations related to the use of bulk estimated obligations.
- For certain types of transactions, such as certain U.S. Transportation Command billings, obligations sometimes may not be recorded until the outlay is made, which can be from a few days or weeks to several months or several years after the obligation should have been recorded.
- For certain types of transactions, there may be an extended period between when the transaction occurred and when the transaction is recorded. For example, U.S. Transportation Command shipment billings that cover multiple fiscal years are initially charged to current fiscal year appropriations, and may not be analyzed and, for shipments related to prior year obligations, may not be properly charged to such prior year appropriations until several months after the end of the fiscal year.
- There are reported internal control weaknesses related to reasonably assuring that all transactions are recorded in the proper period, particularly with regard to liquidations of estimated bulk obligations

[83] 31 U.S.C. §§ 1341-42, 1349-52, 1511-19. The Antideficiency Act, among other things, prohibits agencies from incurring obligations or making expenditures in excess of or in advance of an appropriation, or in excess of an apportionment.

[84] Once it is determined that there has been a violation, the Antideficiency Act requires the agency head to report immediately to the President and the Congress all relevant facts and actions taken, and transmit a copy of the report to the Comptroller General.

[85] GAO-11-830.

related to permanent change-of-station moves and U.S. Transportation Command billings.

AU Section 326 states that the auditor should obtain audit evidence to draw reasonable conclusions on which to base the audit opinion, including performing procedures to detect material misstatements at the relevant assertion level. As part of these procedures, the auditors must perform procedures to assess the risk of material misstatement at the financial statement and relevant assertion levels.[86] AU Section 339 requires documentation of significant findings and issues, actions to address them, and conclusions reached.[87] Although the above risks were known at the time of the audit, and the audit documentation includes a discussion of these risks, the documentation does not include evidence that the auditors appropriately considered these risks as a basis for designing and performing sufficient audit procedures to address these risks. For example, the audit documentation does not contain evidence that DOD OIG auditors performed procedures to assess the risk of proper cutoff and determine the nature, extent, and timing of substantive testing related to (1) the length of transaction cycles for significant volumes of transactions and (2) certain significant general ledger accounts.

The Length of the Fiscal Year-End Cutoff Period Tested Was Not Based on the Risk of Material Misstatement

Our review of the audit documentation determined that the OIG only performed testing of transactions recorded in October 2012 (the first month of fiscal year 2013) for cutoff purposes, based on the assumption noted in the audit documentation that there was a low risk that material amounts recorded in periods subsequent to October could relate to fiscal year 2012. However, there was no documented basis for this judgment. For example, during our discussions with OIG auditors, they told us that based on their experience and auditor judgment, they considered this risk to be low. The auditors did not document their understanding of the length of transaction cycles for significant categories of transactions and the pattern and volume of those transactions at fiscal year-end.

In addition, the audit documentation noted the process whereby U.S. Transportation Command submits summary Interfund billings through IPAC to the Marine Corps that are initially charged to the Marine Corps' fiscal year 2012 appropriations and the Marine Corps' subsequent

[86]AU Section 326, *Audit Evidence*, paras. .20-.21.

[87]AU Section 339, *Audit Documentation*, para. .14.

analysis to determine the allocations of the underlying transactions to the appropriate fiscal year appropriations. However, the audit documentation did not include evidence that the auditors performed any procedures to (1) test the accuracy of the Marine Corps' allocation of fiscal year 2012 shipment billings to previous fiscal year appropriations or (2) confirm that the related adjustments were recorded to ensure that the portion of the outlays that pertained to previous fiscal year appropriations, and in some cases, other military services, were excluded from the outlays reported on the Marine Corps' Fiscal Year 2012 General Fund Schedule. Our analysis of U.S. Transportation Command billings and discussions with the auditors and the Marine Corps determined that the OIG was aware that the Marine Corps was performing analysis of approximately $21 million of fiscal year 2012 shipment billings in January 2013—4 months after the end of fiscal year 2012—to determine the extent of adjustments needed to record the related outlay transactions to fiscal year 2012 and prior appropriations.

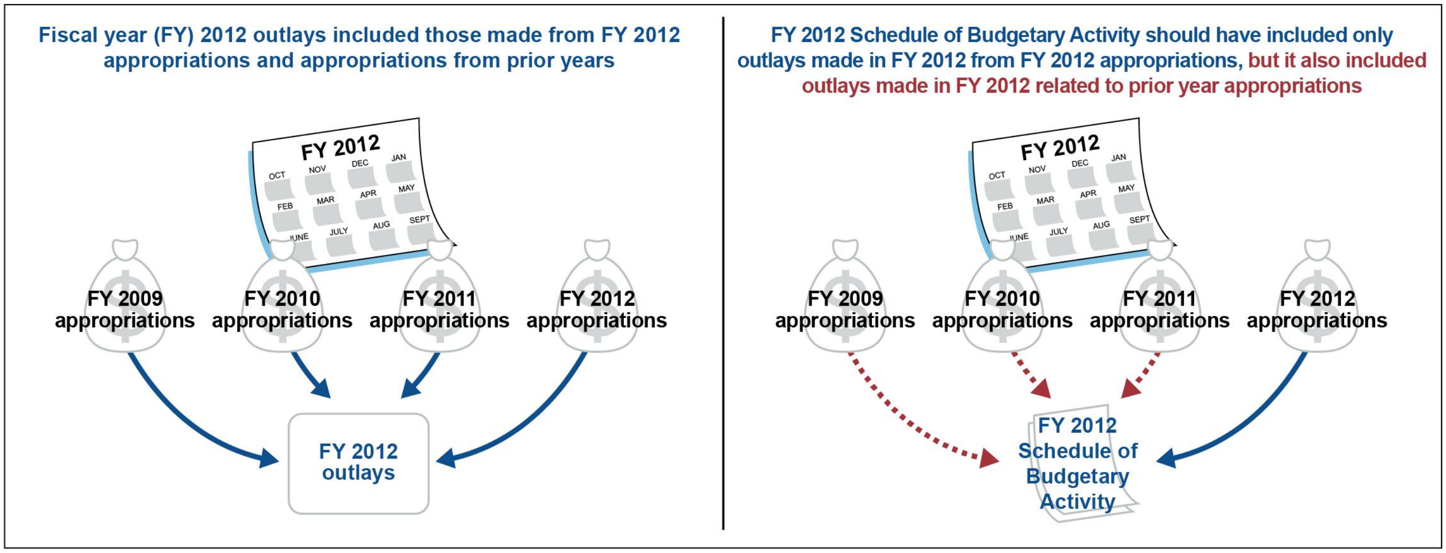
Further, for an audit of budgetary transactions, auditors should test for proper classification to assure that transactions are recorded to the proper fiscal year appropriation or fund account. The OIG told us that testing performed for the audit of the Marine Corps' Fiscal Year 2013 General Fund Schedule would identify any fiscal year 2013 transactions that should have been recorded to fiscal year 2012. The OIG stated that if any cut-off errors were identified during the fiscal year 2013 audit, it would then determine if a restatement of the Marine Corps' Fiscal Year 2012 General Fund Schedule was needed. However, audit evidence obtained in the current year audit should be sufficient to support the auditor's opinion.

The OIG auditors also stated that a normal audit reporting schedule in the federal environment requires issuance of the financial statements and the associated opinion 45 days after the fiscal year ends and this does not allow time for more testing. However, the OIG was not required to meet this reporting time frame for its audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule and had already significantly exceeded it. Given that this was a first-year audit of a 1-year schedule of budgetary activity, additional testing could either have confirmed that a 30-day window was appropriate and thus set a baseline, or would have shown that further efforts were needed by the Marine Corps to address processing delays so that the future 45-day reporting cycle could be met without increasing audit risk.

The audit documentation shows that the OIG tested only the transactions recorded in October 2013 that the Marine Corps applied against fiscal year 2012 appropriations to determine whether they should have been recorded to fiscal year 2012. The OIG did not test transactions recorded in October that were recorded against fiscal year 2013 appropriations to determine if these transactions were properly recorded. As a result, there is a risk that transactions posted to 2013 appropriations should have been recorded in fiscal year 2012 to fiscal year 2012 appropriations. For example, U.S. Transportation Command shipment billings initially recorded to fiscal year 2013 may not have been adjusted and may affect fiscal year 2012 appropriations.

Figure 6 shows a high-level illustration of the scope issue posed by the outlays that actually related to multiple fiscal year appropriations being recorded to fiscal year 2012 appropriations. The audit documentation on substantive testing results for shipment outlays showed that the auditors concluded that the recording of all shipment outlays that were made during fiscal year 2012 to fiscal year 2012 appropriations was accurate, even though the sample shipment outlay transaction documents generally identified allocations that needed to be made to various previous fiscal year appropriations. Support for some sampled shipment outlay transactions initially recorded to fiscal year 2012 appropriations included receiving reports that were dated in August 2011 and September 2011, indicating that they pertained to fiscal year 2011 or earlier appropriations. Further, the documentation on testing results did not include auditor comments that refer to additional procedures performed to ensure that necessary adjustments had been identified by the Marine Corps and that these adjustments were recorded by the close of the fiscal year 2012 accounting period.

Figure 6: Outlays Tested by Auditors Included Amounts for Fiscal Years outside the Scope of the Marine Corps' Fiscal Year 2012 General Fund Schedule of Budgetary Activity



Source: GAO analysis of Marine Corps fiscal year 2012 payment vouchers. | GAO-15-198

Substantive Cutoff Testing Was Not Performed for Significant General Ledger Accounts

The audit documentation also shows that the auditors did not perform any substantive cutoff testing for two general ledger accounts: the obligation account for delivered orders and the outlay account. The OIG told us that it did not test for proper cutoff of the obligation account for delivered orders because any errors identified would result in an adjustment to the obligation account for undelivered orders and would have no net effect on the Marine Corps' Fiscal Year 2012 General Fund Schedule because the two obligation accounts are both reported on the "Obligations Incurred" line item of the Schedule. However, the OIG's testing of the obligation account for delivered orders during fiscal year 2012 substantive testing identified 11 errors for which the corresponding adjustments were recorded to other general ledger accounts and were reported on different line items of the Marine Corps' Fiscal Year 2012 Schedule. Thus, without testing obligations related to delivered orders for proper cutoff, there may be misstatements related to delivered orders that would not be detected by the audit.

With regard to cutoff testing of outlay transactions, the audit documentation showed that after the OIG's tests of internal controls over proper cutoff for outlay transactions resulted in an unacceptably high error rate, the OIG requested that the Marine Corps provide documentation for a sample of 334 outlay transactions for substantive testing of end-of-period cutoff.[88] According to OIG auditors, the Marine Corps responded that it was not able to provide support for this large substantive sample because it was responding to requests for support on sampled transactions that related to the audit of its Fiscal Year 2013 General Fund Schedule at that time.[89] As a result, the OIG attempted to rely on its initial tests of the Marine Corps' internal controls over proper cutoff and extended the time frame for completing its control tests to attempt to resolve the initial exceptions. The audit documentation included statements that the Marine Corps provided additional documentation and that the OIG determined that the documentation was sufficient to resolve all 21 transactions that were initially tested with exception (errors). Our review of Marine Corps documentation identified available support for 18 of the 21 transactions, and we determined that the support was sufficient to resolve only 6 of them. Given that we were unable to find adequate support for 12 transactions, we believe that controls were not effective. Further, even when control tests are effective, they do not eliminate the need for substantive testing.[90]

The OIG Did Not Perform Sufficient Procedures to Reasonably Assure the Reliability of Reported Shipment Obligations

Shipment obligations pertain to shipments of military supplies and equipment and household goods related to permanent change-of-station relocations and related personnel mobilization and permanent change-of-station travel. The Marine Corps reported that it had $529.5 million in fiscal year 2012 shipment obligations. Depending on the type of shipment, the time between obligation and outlay varies. Obligations for shipments of household goods for military members and civilians who are deployed or relocated include amounts for storage costs and reshipment of the items when the personnel return. These obligations, which are funded by Military Personnel appropriations, typically liquidate over a period of 2 or more years. Obligations for shipments of military supplies

[88]The OIG's internal control tests on cutoff were based on random samples of 105 obligation and 105 outlay transactions. For samples of this size, if more than 2 transactions fail the control tests, controls are deemed ineffective. The OIG audit team determined that 21 transactions were tested with exception (errors).

[89]The OIG extended the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule for 9 months—from March 2013 to December 2013—in order to perform additional procedures to support an audit opinion. The OIG awarded the contract for the Marine Corps' fiscal year 2013 audit in March 2013. Consequently, the period of performance for the two audits overlapped.

[90]AU Section 318, *Performing Audit Procedures in Response to Assessed Risk and Evaluating the Audit Evidence Obtained*, para. .09.

and equipment, funded by Operation and Maintenance appropriations, and obligations for shipments funded by Procurement appropriations generally are liquidated within several days or a few weeks.

The audit documentation showed that the OIG had identified several audit risks associated with shipment transactions. For example, the OIG had determined that the Marine Corps (1) did not have sufficient documentation available to support its multiple obligation processes for shipment transactions and (2) was unable to match the liquidations (outlays) with corresponding obligations. The audit documentation also showed that the OIG had attempted to perform substantive testing of the Marine Corps' shipment obligations; however, the Marine Corps was unable to provide support for $231.5 million of its reported $529.5 million in fiscal year 2012 shipment obligations. The audit documentation noted that the lack of supporting documentation related to the Marine Corps' practice of recording (1) bulk estimated obligations for U.S. Transportation Command shipments and (2) obligations for commercial shipments either at the same time or after the associated payments were made. Further, because the Marine Corps was unable to match outlays for specific shipments to its bulk estimated obligations, the auditors could not determine the reliability of obligated balances through detail testing of transactions.

Given the identified issues related to the reliability of recorded transportation obligations, the Marine Corps developed a model to estimate the unliquidated obligations as of the end of the fiscal year. The model was based on historical outlay patterns, using outlay data for fiscal years 2008 through 2012. To illustrate, if historically 75 percent of the outlays relating to an appropriation were expended at the end of the first year, the model would estimate that the remaining 25 percent would be unliquidated obligations for the appropriation. The reliability of the model depends on several factors, including the reliability of the outlay data used in the model; the appropriateness of assumptions used in the model; and the consideration of factors that may affect historical patterns, such as the different outlay patterns for the different types of shipments.

The audit documentation stated that the OIG relied on the auditing standards in testing the Marine Corps' estimated liquidations of shipment obligations. In auditing estimates, auditing standards state that the auditor's objective is to obtain sufficient, appropriate evidence to provide reasonable assurance that the accounting estimates are reasonable in the circumstances. In assessing the reasonableness of the estimate, auditing standards state that the auditor normally concentrates on key factors and assumptions that include sensitivity to variations, deviations from historical patterns, susceptibility to misstatements and bias, and the entity's historical experience related to the reliability of prior year estimates.[91] The auditing standards also identify procedures that the auditor may consider when reviewing and testing the process used to develop management's estimates, including controls over the process, and the relevance, reliability, and sufficiency of historical data used in the estimate.[92]

The audit documentation showed that the OIG performed some review and analysis of the Marine Corps' model for estimating obligated balances related to shipments and made minor adjustments to the model. However, the audit documentation did not contain evidence that the OIG sufficiently performed certain other procedures in AU Section 342 that we believe are important related to (1) identifying whether there were controls over the preparation of the Marine Corps' accounting estimates and the testing of such controls and (2) considering whether sources of data and factors that management used in forming the assumptions were relevant, reliable, and sufficient for the purpose of the estimates based on information gathered in other audit tests.[93] For example, the audit documentation did not contain evidence that the audit team validated the factors management used to form the accounting estimate or performed procedures to test controls over preparation of management's estimates. The audit documentation stated that the auditors performed procedures to assure that the sources and data used in the estimating methodology were relevant, reliable, and sufficient. However, the documentation did not include evidence of sufficient audit procedures performed to provide assurance of the reliability of outlay transaction data used for determining obligation liquidation rates (referred to as the historical burn rates) as a basis for estimating the Marine Corps' obligated balance for shipment transactions at the end of fiscal year 2012. The following examples summarize our concerns with respect to the sources and reliability of the data the OIG used to validate the Marine Corps' model for estimating obligated balances related to shipments at the end of fiscal year 2012.

[91]AU Section 342, *Auditing Accounting Estimates*, para. .09.

[92]AU Section 342, *Auditing Accounting Estimates*, para. .11.

[93]AU Section 342, *Auditing Accounting Estimates*, para. .11.

- The audit documentation showed that the OIG could not validate the completeness of the population of the Marine Corps' reported shipment obligations as a basis for estimating the balance of shipment obligations at the end of fiscal year 2012 because (1) about $213 million related to bulk estimated obligations for which specific supporting documentation was not available and (2) about $19 million related to obligations that were based on billings and payment amounts and it was not possible to determine additional obligation amounts for shipments that had been made but had not yet been billed. Further, the audit documentation stated that the Marine Corps was unable to match liquidations (outlays) to reported obligations.
- The audit team did not perform procedures to confirm the reliability of U.S. Transportation Command system-generated Interfund billing data reported through IPAC, even though the DOD OIG had previously reported issues with the reliability of budgetary transactions reported by DEAMS and the OIG was aware that controls over other U.S. Transportation Command systems had not been tested.
- The OIG performed limited internal control tests over shipment outlays for a 5-year period covering fiscal years 2008 through 2012. The audit documentation showed that the audit procedures relied on (1) Marine Corps fiscal year 2008 and 2009 outlay data that had not been audited, (2) fiscal year 2010 and 2011 outlay data included in SBRs for which the OIG disclaimed an opinion, and (3) fiscal year 2012 outlay data that were tested by comparing SABRS shipment outlay transactions to the dates and amounts on disbursement vouchers instead of original transaction support and concluded that there were no errors. However, these disbursement vouchers are used to record shipment outlay transactions in SABRS and thus do not provide independent assurance of the accuracy of the outlay transactions.
- The audit documentation for internal control tests on outlays for each fiscal year used in the model consistently noted that the auditors were unable to determine the completeness of the shipment outlay populations used for testing. Further, the issues discussed in this report, such as those related to completeness and cutoff, may affect assurance of the reliability of outlay data used in the model.
- The audit documentation did not show that the OIG sufficiently considered the effect that different types of shipment transactions liquidated at different rates might have on estimated obligation balances because the OIG could not determine the populations for the various shipment processes. Members of the audit team told us that they generalized their tests and did not separately test liquidations for different types of shipments.

Based on its audit of the Marine Corps' accounting estimate of its fiscal year-end 2012 balance of shipment obligations, the OIG determined that the Marine Corps' reported balance of obligations at the end of fiscal year 2012 was overstated, and the audit documentation indicated that the OIG proposed a downward adjustment of $53.7 million, which was recorded by the Marine Corps. However, the reliability of the estimated fiscal year-end obligated balance reported in the Marine Corps' Fiscal Year 2012 General Fund Schedule is uncertain because of (1) the lack of assurance over the completeness and reliability of the shipment obligation and outlay data used to estimate the ending balance of obligations and (2) the application of a generalized liquidation rate for shipments that had significant differences in liquidation periods. As a result, obligations related to shipments reported in the Marine Corps' Fiscal Year 2012 General Fund Schedule may not be complete and reliable.

As discussed later in this report, because of the significance of U.S. Transportation Command activity to DOD-wide audit readiness, in September 2013, the department initiated a DOD-wide Transportation Financial Auditability working group to document and test transportation processes, systems, and controls. The OIG is aware of this initiative. Accordingly, the OIG should have appropriately considered the risk associated with the Marine Corps' shipment outlay transactions and performed sufficient procedures to assure the reliability of shipment outlay amounts reported in the Marine Corps' Fiscal Year 2012 General Fund Schedule.

The OIG Did Not Properly Consider and Evaluate Audit Evidence in Concluding on the Audit

The OIG's conclusion on the results of the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule did not consider all known misstatements and untested amounts; explain the basis for certain significant assumptions and auditor judgments; or properly resolve disagreements among the audit team, statisticians, and OIG management.

The OIG's Evaluation of Test Results Did Not Include All Known Misstatements or Consideration of Other Known Risk Factors

As discussed in the auditing standards, in evaluating whether the financial statements are presented fairly, in all material respects, in conformity with GAAP, the auditor must consider the effects, both individually and in the aggregate, of misstatements (both known and likely) that are not corrected by the entity.[94] At the conclusion of the audit, the auditor accumulates identified misstatements and considers whether such misstatements are material to the entity's financial statements. In addition to quantitative measures, the auditor is also required to consider qualitative factors when assessing the materiality of misstatements.[95] Auditing standards further state that as the aggregate misstatement identified in testing approaches materiality, the risk that the financial statements could be materially misstated also increases; consequently, the auditor should consider the effect of undetected misstatements in concluding on whether the financial statements are fairly stated.[96]

As previously discussed, in concluding on the audit, the auditor makes judgments about materiality in light of surrounding circumstances and qualitative and quantitative considerations. These judgments are affected by the auditor's perception of the financial information needs of users of the financial statements by the size or nature of a misstatement, or both. As a basis for quantitative considerations on the results of testing, the auditor establishes a materiality level, or the maximum level of misstatement the auditor is willing to accept in concluding on the audit without the amount of misstatement being misleading to the users of the financial information.[97] Federal government auditors generally set materiality for reporting on audit results at 3 percent of the materiality base. The materiality base is the element of the financial statement(s) that the auditor judges as most significant to the primary users of the statements. For the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule, the OIG used the reported Obligations Incurred line item amount of $27.5 billion as the materiality base. Accordingly, the OIG set materiality at 3 percent of the materiality base for the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule, which was $826 million.

[94]AU Section 312, *Audit Risk and Materiality in Conducting an Audit*, para. .50.

[95]AU Section 312, *Audit Risk and Materiality in Conducting an Audit,* paras. .04, .59, and .60.

[96]AU Section 312, *Audit Risk and Materiality in Conducting an Audit*, paras. .41 and .65.

[97]AU Section 312, *Audit Risk and Materiality in Conducting an Audit*, para. .04.

The audit documentation showed that the OIG calculated the level of identified misstatement related to errors and untested amounts identified in its audit as approximately $773 million. Based on this evaluation, the auditors concluded that the aggregate of identified misstatements and untested amounts was not material to the Marine Corps' Fiscal Year 2012 General Fund Schedule.

Our review of the audit documentation found that the OIG's analysis of its test results omitted certain known errors and untested amounts. Specifically, the OIG's audit calculation of identified misstatements omitted $18.3 million in contract progress payment errors identified in tests of obligations and another $17.5 million related to insufficient documentation to conclude on tests of contract outlays—a total of $35.8 million. The audit documentation showed that the audit team had initially determined that it could not conclude on the accuracy of sampled contract outlay transactions for which there was no support that the goods and services paid for were received. Accordingly, the OIG audit team counted the related transaction amounts as untested and planned to include them in the calculation of identified misstatements. The audit documentation showed that OIG management made an assumption that the unsupported outlay transactions could be adjusted and reported as advance payments to avoid counting the amounts as untested. The audit documentation stated that because outlays and advances are reported on the same line item of the General Fund Schedule, the adjustment would have no net effect on the Schedule. However, advances typically require authorization[98] in law or in contract and without documentation of such authorization the advance should be considered untested. Had the auditors included the contract progress payment errors as untested amounts, the identified misstatement would have totaled over $808 million. The OIG's handling of differences of opinion between the audit team and OIG management is discussed further below.

[98]As a general matter, federal agencies may only make advance payments where specifically authorized by law; see 31 U.S.C. § 3324(b). The Economy Act, 31 U.S.C. § 1535, allows agencies to pay in advance for goods or services ordered from other federal entities, and DOD has legal authority, subject to certain conditions and limitations, to utilize advances in contract financing. *See* 10 U.S.C. § 2307. However, even where statutory authority is present, the specific contract under which the payment is being made must support advance payment. *See* Federal Acquisition Regulation, 48 C.F.R. §§ 32.2, 32.4.

Additionally, the audit documentation did not include evidence that the OIG considered potential undetected misstatements in concluding on the fair presentation of the Marine Corp's Fiscal Year 2012 General Fund Schedule. Also, the audit documentation did not include evidence that the OIG considered qualitative factors in concluding on the effect of identified and potential undetected misstatements.

As noted above, the OIG's identified misstatements and untested amounts are quantitatively near the calculated materiality. Based on the issues discussed above and other issues discussed previously in this report—including those related to (1) completeness of transactions reported in the Marine Corps' Fiscal Year 2012 General Fund Schedule, (2) transaction cutoff, (3) estimation of obligations, and (4) reliance on information in other DOD systems—additional misstatements may exist that may have been identified had additional audit procedures been performed. Such further misstatements, when aggregated with identified misstatements, could be material. Consequently, sufficient, appropriate evidence was not obtained to support the conclusion that the Marine Corps' Fiscal Year 2012 General Fund Schedule is presented fairly.

The OIG Did Not Follow Guidance in Its *Audit Handbook* for Statistician Review and Certification of Sample Results

The OIG's *Audit Handbook* describes roles and responsibilities of its Quantitative Methods Division's (QMD) technical support of DOD audits.[99] QMD's roles in support of financial audits include technical assistance in determining the appropriate population as a basis for ensuring defensible results, guidance on statistical sampling methods, design of a sampling plan, and analysis of sample results. The OIG's *Audit Handbook* states that the QMD analyst will attend project debriefs and exit conferences and answer any questions about the quantitative (statistical) sampling approach and the uses and limits of the quantitative results. In addition, the QMD analyst will help the audit team correctly present quantitative results in the audit report and will certify the defensibility of the significant quantitative methods used in the audit report. However, the audit documentation showed that QMD did not sign off as certifying the auditors' projections of sample results because of concerns about the auditors mixing two methods for making statistical estimates. Instead, QMD added a note to the certification form, stating that it expressed no opinion as to the application (i.e., projection) of results with respect to the

[99]Department of Defense, *Deputy Inspector General for Auditing, Audit Handbook*, Sixth Edition, ch. 1.4 (Mar. 31, 2008; updated as of Dec. 15, 2011).

evaluation of sample results against materiality. QMD officials told us that the reason they did not sign off on the auditors' materiality assessment is that they were not included in the materiality assessment process and did not know the basis for the auditor judgments made. QMD officials explained that this was unusual and stated that they are generally included in auditor assessments of materiality.

Significant Auditor Judgments Made in Determining the Audit Opinion Were Not Documented

Auditing standards recognize that auditors must use professional judgment in concluding on an audit.[100] Auditors also are required to document significant decisions in their audit documentation.[101] The audit documentation for the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule showed inconsistencies and conflicting conclusions between the audit team and OIG management regarding the scope of audit testing and the OIG's conclusions on the results of audit testing, including testing for cutoff, shipment obligations and outlays, and acceptance of unaudited system-generated data for substantive testing of transactions. These conflicting conclusions indicate that significant auditor judgments had been made regarding the audit results and audit conclusion, but the audit documentation did not include a reconciliation or explanation for the conflicting statements. Further, these undocumented auditor judgments related to decisions made by OIG management that overturned the audit team's test results and conclusions. The following examples illustrate this issue.

- The audit team's conclusions on cutoff testing stated that because the Marine Corps did not have controls for assuring that obligations were recorded in the proper period, the team was unable to gain assurance of the completeness of populations used for this testing and, as a result, was unable to conclude on the completeness of the Obligations Incurred and the Outlays line items or the fair presentation of the Obligations Incurred line item in the Marine Corps' Fiscal Year 2012 General Fund Schedule. The audit documentation did not contain any further audit procedures that were performed or auditor explanations that indicated that this issue had been resolved. Further, because the Obligations Incurred line item, reported at nearly $27.5 billion,

[100]AU Section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, para. .75, and GAO-07-731G, *Government Auditing Standards,* section 3.31.

[101]AU Section 339, *Audit Documentation*, paras. .16 and .17, and GAO-07-731G, *Government Auditing Standards*, section 3.38.

represents all but about $1.9 billion of the Marine Corps' fiscal year 2012 budgetary resources, the inability to conclude on the fair presentation of this line item would mean that the extent of fair presentation of the Marine Corps' Fiscal Year 2012 General Fund Schedule also could not be determined. Further, the audit documentation did not show OIG management's basis for determining that cutoff testing was sufficient.

- The audit documentation related to the OIG's application of the Marine Corps' model for estimating the year-end balance of shipment obligations included at least six individual workpapers in which the audit team had concluded that it was unable to gain assurance as to the completeness of populations used for testing historical (fiscal year 2008 through 2011) shipment liquidation transactions (outlays). In concluding on the testing for this category of transactions, the audit team stated that this issue posed a scope limitation. However, as previously discussed, the OIG ultimately relied on historical liquidations data for determining a "burn rate" (liquidation or outlay rate) for fiscal year 2012 as a basis for assessing the reasonableness of reported fiscal year-end 2012 obligated balances. We found no documentation of the basis for the OIG management decision that the limited procedures performed were reliable for use in estimating year-end obligated balances. This is a significant issue because shipment obligations reported by the Marine Corps as totaling over $529 million represent two-thirds of the materiality threshold used by the OIG to conclude on the audit. As previously discussed, identified misstatements and untested amounts were quantitatively near the calculated materiality without considering this amount.

In addition, our review of the audit documentation identified numerous e-mail communications during the months of November and December 2013, shortly before the audit report was issued, that indicate there was a disagreement between the audit team and OIG management regarding whether there was sufficient, appropriate audit evidence to support an unqualified ("clean") audit opinion. The e-mails showed that the audit team did not believe it had the evidentiary support for the clean opinion and was asking for OIG management guidance regarding the basis for issuing an unqualified opinion. The e-mails also showed that OIG management instructed the audit team that a decision was made that the Marine Corps had "earned" an unqualified opinion and that the audit documentation needed to be updated to support the clean opinion. The audit documentation did not include an explanation of the basis for the OIG management judgment related to the opinion. Consequently, the audit documentation showed a gap between the audit team's conclusions relating to a disclaimer and the clean opinion that was reported by the OIG in December 2013.

Audit quality control standards (designated QC by the AICPA) state that audit organizations should establish policies and procedures for addressing and resolving differences of opinion within the engagement team; with those consulted; and, when applicable, between the engagement partner and the engagement quality control reviewer.[102] Such policies and procedures should enable a member of the engagement team to document his or her disagreement with the conclusions reached after appropriate consultation.[103] Such policies and procedures should require that (1) conclusions reached be documented and implemented and (2) the audit report not be released until the matter is resolved.[104] Our review of the OIG's *Audit Handbook* and the *DOD Audit Manual*,[105] and discussions with the OIG Audit Policy and Oversight officials, determined that the OIG does not have policies and procedures for resolving disagreements between the audit team and OIG management.

[102]QC Section 10*, Firm's System of Quality Control*, para. .46, and GAO-07-731G, *Government Auditing Standards*, which refers to AICPA standards and describes elements of a government audit organization's system of quality control in ch. 3, sections 3.53 through 3.54, and provides supplemental guidance in sections A3.04 a. (1) through (8). Also see AU Section 339, *Audit Documentation*, paras. .16–.17.

[103]QC Section 10, *Firm's System of Quality Control*, para. .47, and GAO-07-731G, *Government Auditing Standards*, section A3.04 a. (6).

[104]QC Section 10, *Firm's System of Quality Control*, para. .48.

[105]Department of Defense, *Department of Defense Manual*, DOD 7600.7-M (Feb. 13, 2009). The DOD Manual is commonly referred to by DOD as the *DOD Audit Manual*.

The Marine Corps Has Not Taken Timely Actions to Address Identified Accounting, Reporting, and System-Related Internal Control Weaknesses

The OIG issued 177 recommendations to address deficiencies in internal controls[106] over Marine Corps' accounting and financial reporting and information technology system general operating controls as a result of its audits of the Marine Corps' fiscal year 2010 and 2011 SBRs and the Marine Corps' Fiscal Year 2012 General Fund Schedule.[107] Based on our review of OIG documentation, 130 (73 percent) of these recommendations had not been fully addressed by the end of the fiscal year 2012 Marine Corps audit. This includes 22 recommendations that we determined the OIG closed prior to verifying and documenting that implementation of the recommended controls was complete and fully addressed the recommendations. In addition, we made 3 recommendations to the Marine Corps in our September 2011 report on the Marine Corps' fiscal year 2010 SBR audit results, all of which remained open as of March 2015.[108] The Marine Corps has improved its remediation plan and strengthened its monitoring process and is taking a more risk-based approach to corrective actions. However, significant uncorrected control weaknesses continue to impair the Marine Corps' ability to produce consistent, reliable, and sustainable financial information for day-to-day decision making on its missions and operations. The lack of reliable financial information and systems, processes, and controls also impedes the Marine Corps' ability to achieve sustainable, cost-effective audit efforts.

[106]Internal control comprises the plans, methods, and procedures to provide reasonable assurance that objectives are being achieved in the following areas: (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations.

[107]Department of Defense, Office of Inspector General, *Independent Auditor's Report on the United States Marine Corps General Fund FY 2010 and FY 2009 Combined Statement of Budgetary Resources*, D-2011-009 (Arlington, VA: Nov. 8, 2010); *Independent Auditor's Report on the United States Marine Corps General Fund FY 2011 and FY 2010 Combined Statement of Budgetary Resources*, DODIG-2012-016 (Alexandria, VA: Nov. 22, 2011); and *Independent Auditor's Report on the United States Marine Corps Schedule of Current Year Budgetary Activity for FY 2012*, DODIG-2014-028 (Alexandria, VA: Dec. 20, 2013).

[108]GAO-11-830.

The Marine Corps Has Made Limited Progress in Addressing Internal Control Weaknesses Identified by the OIG

Our review of the OIG's documentation on the status of actions to address its recommendations to Marine Corps management resulting from its fiscal years 2010 through 2012 audits of the Marine Corps budgetary activity showed that as of the end of its audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule, 130 of the 177 recommendations issued had not been fully addressed. The 130 open recommendations included 16 recommendations that were issued from August 2012 through February 2013 to address deficiencies identified in the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule. The majority of the 130 open recommendations related to the Marine Corps' fiscal year 2010 first-year SBR audit. In addition to presenting impediments to the Marine Corps' financial management operations, the weaknesses that gave rise to these recommendations also impede the Marine Corps' ability to respond to audits and the auditors' ability rely on the Marine Corps' internal controls in planning and conducting audits. This results in the auditors having to perform labor-intensive substantive tests of larger samples of transactions that consume more time and resources than would be required if the Marine Corps' internal controls were effective. While it is important for the Marine Corps to address these recommendations timely, Marine Corps officials told us that progress has been limited because Remediation Team staff are used to support financial audits and the Marine Corps has experienced difficulty hiring additional qualified staff. Table 1 summarizes our analysis of the OIG's documentation on the status of Marine Corps actions taken to address the OIG recommendations from the fiscal year 2010 through 2012 audits.

Table 1: Open Recommendations from the Fiscal Years 2010 through 2012 Marine Corps Budgetary Audits (as of the End of the Fiscal Year 2012 Audit)

Recommendation categories by fiscal year	Number issued	Closed per OIG	Open per OIG	Open per GAO	Difference in number deemed open
Accounting and financial reporting:					
FY 2010	50	11	39	43	4
FY 2011	17	0	17	17	0
FY 2012	15	0	15	15	0
Subtotal, Accounting and financial reporting	**82**	**11**	**71**	**75**	**4**
Information technology systems:					
FY 2010 - MCTFS	28	15	13	18	5
FY 2010 - SABRS	35	26	9	16	7
FY 2010 - DDRS	25	13	12	16	4
FY 2010 - Subtotal	**88**	**54**	**34**	**50**	**16**
FY 2011 - DCAS	6	4	2	4	2
FY 2012 - SABRS	1	0	1	1	0
Subtotal, Information technology recommendations	**95**	**58**	**37**	**55**	**18**
Total, all recommendations	**177**	**69**	**108**	**130**	**22**

DCAS: Defense Cash and Accountability System

DDRS: Defense Departmental Reporting System

FY: fiscal year

MCTFS: Marine Corps Total Force System (military payroll)

OIG: Office of Inspector General

SABRS: Standard Accounting, Budgeting, and Reporting System (Marine Corps general ledger).

Source: GAO analysis. | GAO-15-198.

Note. Auditor Notifications of Findings and Recommendations from the Marine Corps' fiscal year 2012 audit were issued to the Marine Corps from August 2012 through February 2013.

OIG managers told us that their policy is to evaluate corrective actions on OIG and GAO recommendations and close them as appropriate. However, as noted in table 1, we determined that 22 recommendations that the OIG had closed should have remained open. Our analysis of the audit documentation on the Marine Corps' corrective actions determined that support was not sufficient for closing these recommendations for the following reasons.

- Four recommendations called for development of written policy and procedures and the implementation of the related control procedures. The documentation on the Marine Corps' actions only supported the development of the written policy and procedures. There was no documented evidence that the policy and procedures as designed had been effectively implemented.

- Six recommendations related to the completeness and accuracy of data transfers from DOD business systems to the Marine Corps' SABRS general ledger system were closed without any evidence of procedures being performed to confirm that the data transferred to SABRS were complete.
- Four recommendations were closed because the auditors' substantive testing did not identify any related exceptions, even though there was no documentary evidence that the Marine Corps had designed and implemented corrective actions.
- The remaining eight recommendations were closed without sufficient documentation that actions were completed and verified as effective.

The auditors told us that they planned to test implementation of several controls in a subsequent audit. However, absent evidence that the new controls had been effectively implemented, closing these recommendations creates a risk that corrective actions needed may not be completed and that the related weaknesses will continue to exist.

Significant Uncorrected Internal Control Weaknesses Pose a Risk to Sound Financial Management Processes and Sustainable Audit Efforts

Our review of the Marine Corps' open recommendations identified numerous uncorrected financial reporting and information system control weaknesses that if effectively resolved, would significantly improve the Marine Corps' ability to achieve reliable financial reporting and more efficient audit efforts. The following examples summarize recommendations related to significant weaknesses that had not yet been corrected and thus impair the Marine Corps' ability to generate reliable financial management information on an ongoing basis for decision making and achieve and sustain auditable budgetary information.

- Sixteen of the Marine Corps' open recommendations related to weaknesses in controls for assuring completeness, including transfers of feeder system data to its SABRS general ledger system and timely recording of transactions. These open recommendations addressed actions to (1) assure completeness of populations of transactions and account balances, (2) test interface controls between various feeder systems and the Marine Corps' SABRS general ledger system, and (3) perform reconciliations of feeder system data to SABRS.
- Thirty-five open recommendations related to weaknesses in controls over the reliability of feeder system data, including systems security, access controls, and data processing controls. Open recommendations related to data reliability include recommendations

to (1) implement periodic review of input processing and edit checks that could produce exception reports; (2) ensure timely, accurate recording of transactions; and (3) strengthen information system data integrity and access controls.

- Forty-three open recommendations related to weaknesses in controls for assuring proper support for obligations and outlays. These weaknesses affect the support for MILSTRIP, shipment, and contract transactions. Open recommendations related to the reliability of reported obligations and outlays include actions to (1) ensure proper recording of obligation and outlay transactions; (2) reconcile shipment outlays to obligation transactions; (3) periodically review accrued delivered orders and identify amounts that should be deobligated; (4) review support for existing bulk estimated obligation documents and adjust the beginning obligated balance, as appropriate; (5) ensure supporting documentation traces to and supports amounts recorded in SABRS; and (6) improve monitoring controls over IPAC transactions.

In addition to achieving improvements in the overall integrity and reliability of its financial operations and information, the Marine Corps would benefit from resolving these significant control weaknesses because (1) strengthened processes and controls would provide a basis for the auditors to reduce sample sizes and (2) strengthening controls for assuring the reliability of feeder system data would reduce efforts to locate original support for transactions, thereby reducing the Marine Corps' efforts to respond to requests for large samples and auditor efforts to perform labor-intensive substantive tests of larger samples of transactions that consume more time and resources than would be required if the Marine Corps' internal controls were effective. Further, developing audit support agreements with other DOD components that support the Marine Corps' mission by providing services and supplies as well as the related obligation and outlay data would help support the Marine Corps' efforts to respond to its financial audits. For example, such agreements could assist the Marine Corps in documenting mission-related processes, systems, and controls and taking appropriate actions to address any weaknesses identified in such efforts. The overall benefit from these efforts would be financial management improvement.

In August 2014, we followed up with Marine Corps officials to discuss their progress on addressing open recommendations from the Marine Corps' fiscal years 2010 through 2012 audits. Of the 75 open accounting and financial reporting recommendations, our analysis showed that in February 2014, the auditors closed 48 recommendations and consolidated and reopened 22 of them as new recommendations associated with performance of the audit of the Marine Corps' Fiscal Year

2013 General Fund Schedule. The officials told us that the purpose of this effort was to clarify finding and recommendation language to help the Marine Corps identify underlying control weaknesses and develop appropriate corrective actions to resolve the causes of the weaknesses. In reissuing the consolidated recommendations, the auditors grouped findings with similar causes and remediation steps into an overall recommendation. However, our analysis determined that the other 27 recommendations were closed by the auditors. Documentation that the Marine Corps provided us in August 2014 stated that the weaknesses remained, including those related to 6 recommendations for correcting weaknesses associated with use of bulk estimated obligations; 10 recommendations for timely fund manager reviews, including review of “stale” obligations (obligations without activity for more than 120 days) to see if they are needed or should be deobligated; and 6 recommendations related to timely correction of DDRS financial reporting errors and monthly management reviews of all journal vouchers for proper recording. The auditors did not consolidate or close any of the previously issued information technology system recommendations during this period.

The auditors told us that their decision to close these 27 recommendations was based on the results of substantive testing performed for the audit of the Marine Corps’ Fiscal Year 2013 General Fund Schedule. The auditors explained that nothing related to the previously identified weaknesses came to their attention during their substantive testing for the Marine Corps’ fiscal year 2013 audit. However, the absence of identified misstatements alone is not sufficient for determining whether internal control weaknesses have been remediated.

Regardless of whether the number of recommendations to address control weaknesses has been reduced, for example, because the auditors consolidated them, timely and effective actions to resolve underlying causes of control deficiencies related to (1) completeness of data transferred from DOD feeder systems to the Marine Corps’ SABRS general ledger system, (2) reliability of financial data and information generated by DOD feeder systems, and (3) ensuring availability of supporting documentation for obligations and outlays will be critical to achieving sustainable financial management improvement and financial audit efforts.

The Marine Corps Has Made Progress in Addressing Previous GAO Audit Recommendations

Our September 2011 report on the Marine Corps' fiscal year 2010 SBR audit results included three recommendations to the Marine Corps.[109] While the Marine Corps has made progress in addressing our recommendations, all three recommendations remain open.

The Marine Corps has not yet fully addressed our recommendations that it (1) use the results of its fiscal year 2010 and 2011 SBR audits to develop a comprehensive, risk-based plan for designing and implementing corrective actions that provide sustainable solutions for SBR auditor recommendations; (2) review Marine Corps SBR remediation actions under way and confirm that the actions are fully responsive to the auditor recommendations; and (3) develop and implement timely and effective agreements for audit support with the appropriate DOD components in accordance with the FIAR Guidance where remediation actions require a coordinated effort.[110]

The Marine Corps has established the Risk and Compliance Branch to support its audit readiness efforts. The Marine Corps also assigned new leadership to its Remediation Team and moved the team under the Risk and Compliance Branch to provide more focus on remediation of identified weaknesses. The Remediation Team is responsible for coordinating, monitoring, and validating the design and effectiveness of corrective actions to address audit recommendations and findings from management and internal reviews.

DOD stated that the Marine Corps disagreed with our recommendation to develop a comprehensive, risk-based corrective action plan, stating that it was too prescriptive with regard to identifying roles and responsibilities and including performance indicators to measure performance against action plan objectives. However, under its new Risk and Compliance Branch, the Marine Corps subsequently developed a detailed remediation process that includes elements of a comprehensive, risk-based plan as called for in our recommendation. For example, according to the Marine Corps, it now identifies weaknesses associated with audit findings that the auditors grouped by categories and works with process owners and

[109] GAO-11-830.

[110] Department of Defense, Office of the Under Secretary of Defense (Comptroller)/CFO, *Fiscal Year 2010 Financial Improvement and Audit Readiness (FIAR) Guidance* (May 15, 2010).

stakeholders to understand the causes of the weaknesses and develop corrective action plans that will be effective in resolving them. Our review of the Marine Corps' new remediation process found that Marine Corps officials also had assigned a high, medium, or low priority to each recommendation based on risk; however, they had not yet developed written criteria or guidance for determining how to apply these priorities in order to focus corrective actions on the most significant areas of weakness.

In response to our second recommendation, as part of the new remediation process, the Marine Corps also incorporated an independent stakeholder review and monitoring role with responsibility for ensuring that corrective actions fully address auditor recommendations as well as any recommendations resulting from internal management reviews. However, the Marine Corps has not yet provided documentation of the stakeholder reviews to demonstrate that this action is fully implemented and operating as intended.

With regard to our third recommendation, Marine Corps officials told us that they have initiated efforts to develop agreements for audit readiness support with the appropriate DOD components. For example, they have a draft audit support agreement with DLA that covers audit support related to DLA-performed business processes that generate financial information that the Marine Corps will rely on for financial statement reporting and audit purposes. These DLA business processes include (1) receiving and accepting goods, (2) storing material, (3) issuing and distributing material, (4) disposing of material, and (5) updating accountability records. Marine Corps officials told us that where audit support depends on DOD-wide systems, processes, and controls related to MILSTRIP and U.S. Transportation Command shipments, they believe the DOD Comptroller and FIAR Directorate should take the lead in developing the service-level agreements.

The Marine Corps Audit Identified Significant Challenges for DOD-Wide Financial Improvement and Audit Readiness Efforts

Our review of the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule identified major areas where key Marine Corps business processes depended on other DOD agencies' business processes and feeder systems with data reliability issues that transferred financial data and information to its general ledger system. Because other DOD components also rely on many of those same DOD agencies' business processes and feeder systems, these issues will likely present DOD-wide challenges related to (1) ensuring the completeness of populations used for transaction testing and the proper cutoff of transactions for the accounting period, (2) determining the reliability of feeder system data transferred to the general ledger system, and (3) determining the reliability of reported obligations and outlays. These DOD-wide challenges have been known for many years. Since December 2011, DOD's FIAR Guidance has included these challenges in a list of "dealbreakers" that if not effectively resolved, would pose a significant challenge to achieving financial management improvement as well as audit readiness. To the extent that these challenges are not resolved, they will pose serious obstacles to the military services, which are currently undergoing first-time audits of their fiscal year 2015 General Fund schedules of budgetary activity, and could also pose obstacles to DOD's efforts to achieve audit readiness on a full set of financial statements for fiscal year 2018.

Completeness of Populations and Proper Cutoff Are Critical to DOD-Wide Audit Readiness

In May 2014, we reported that DOD had an inventory of 2,329 business systems, including 286 financial management systems; 702 logistics systems; 730 human resources management systems (including payroll systems); and numerous acquisition, logistics, and other business systems.[111] The vast majority of the department's financial transactions originate in these business systems that then feed financial transaction data—including data for military and civilian payroll, supplies and procurements, travel, work orders, and shipments—to DOD general ledger systems. As identified in our review of the Marine Corps' fiscal year 2012 audit, performing tests to assure the completeness and reliability of DOD business systems data and performing periodic reconciliations of business system data to general ledger systems are necessary to provide reasonable assurance that military service and

[111]GAO, *Defense Business Systems: Further Refinements Needed to Guide the Investment Management Process*, GAO-14-486 (Washington, D.C.: May 12, 2014).

defense agency financial statements include all transactions and balances that should have been recorded for the period. This will be a challenge across DOD given the large number of feeder systems and the fact that the controls over most systems have not yet been tested. Without assurance of completeness of populations used for audit testing, auditor sampling and testing results will not provide the reasonable assurance necessary for concluding on an audit and forming an opinion. DOD's FIAR Guidance continues to identify the inability to provide assurance of complete populations (i.e., reconcile the general ledger to transaction detail, including feeder system detail) as an audit readiness dealbreaker.

As a subset of completeness, proper fiscal year-end cutoff of transaction activity and assurance that appropriation data are recorded to the proper fiscal year are essential to ensuring that the financial statements and the schedules of budgetary activity include all data for the accounting period audited. As previously discussed, the population of transactions for shipments of household goods and military items used in the Marine Corps' fiscal year 2012 audit contained liquidations (outlays) related to one or more previous fiscal year appropriations. Because the Marine Corps was unable to reconcile its fiscal year 2012 bulk estimated obligations to the related outlays, and outlays recorded to fiscal year 2012 included outlays that were properly chargeable to prior fiscal year appropriations, the populations of obligations and outlays provided to the auditors for sampling and testing were not consistent with the reported scope of its Fiscal Year 2012 General Fund Schedule. Since the other military services also use bulk estimated obligations to fund their business processes whose transaction cycles cover multiple fiscal years, the inability to segregate outlays by appropriation fiscal year poses a significant risk to the integrity of their schedules of budgetary activity, particularly with regard to first-year schedules. For example, when bulk estimated obligations liquidate over several fiscal years, identifying a population of transactions that relates to a first- or even a second-year schedule of budgetary activity is problematic. This issue poses a significant audit readiness challenge for the other military services' first-time audits of their schedules of budgetary activity, which have been initiated for fiscal year 2015.

The Reliability of DOD System-Generated Data Has Not Been Validated

The Marine Corps' fiscal year 2012 audit demonstrated the difficulty in performing a fully substantive audit. For example, when the Marine Corps was unable to provide documentary support for certain transactions, it attempted to rely on (1) data and information generated by DLA systems and processes that support MILSTRIP transactions and (2) information generated by U.S. Transportation Command systems and processes for shipments of military items and household goods. This is directly contrary to the DOD FIAR Guidance on audit dealbreakers related to DOD feeder systems, which states that substantive testing of transactions to supporting documentation cannot overcome ineffective or missing information technology system controls when transaction evidence is electronic and only maintained within a system or the key supporting evidence is system-generated reports.[112]

The other military services and some DOD agencies use these same mission support agencies' business processes and systems to issue and ship military supplies and equipment and ship household goods, and they make payments (outlays) based on billings generated by these agencies' business feeder systems. To the extent that the other military services are unable to locate original support for tested transactions, there is a potential risk that if DOD mission support agencies' systems and processes are not tested to reasonably assure the reliability of transaction data, the other military services' and DOD will experience the same problem as the Marine Corps. Accordingly, DOD's FIAR Guidance recognizes that for large volumes of transactions, it is more effective and efficient to rely on internal controls, including information system controls, rather than planning to fully rely on substantive testing of larger numbers of sampled transactions for which documentary support must be located and provided to the auditors. Since December 2011, DOD's FIAR Guidance has stated that DOD mission support agencies are responsible for resolving dealbreakers related to their information systems, processes, and controls and obtaining SSAE No. 16 examinations. However, because of uncorrected accounting, reporting, and information system weaknesses, the Marine Corps has relied primarily on costly, labor-intensive efforts to locate and provide documentary support for substantive tests of transactions.

According to DOD's November 2014 FIAR Plan Status Report, DLA and U.S. Transportation Command are still in the beginning stages of their audit readiness efforts. As a result, the military services and defense agencies have asserted audit readiness for their fiscal year 2015

[112] Department of Defense, Office of the Under Secretary of Defense (Comptroller)/CFO, *Financial Improvement and Audit Readiness (FIAR) Guidance*, section 3 (December 2011).

schedules of budgetary activity without these mission-support agencies having undergone SSAE No. 16 examinations.

Until these support agencies' systems, controls, and processes have been tested and are deemed reliable for financial management reporting and audit purposes, the Marine Corps, the other military services, and defense agencies that rely on these systems and processes may experience the same challenges we identified in the Marine Corps' fiscal year 2012 audit with regard to providing support for shipment transactions in audits of their fiscal year 2015 General Fund schedules of budgetary activity.

Ability to Assure the Reliability of Reported Obligations and Outlays Is Questionable

The Marine Corps' fiscal year 2012 audit identified serious issues regarding the reliability of reported obligations and outlays. These issues relate to effective processes and controls for reasonably assuring (1) proper cutoff of beginning- and end-of-period obligations and outlays and (2) reported shipment obligations and outlays reflect activity for the accounting period audited. Because the Marine Corps and other military services record shipment obligations and outlays that occurred during each accounting period to current year appropriations, subsequent research and analysis are required to determine the appropriate fiscal year appropriation to be charged and to make necessary adjustments to both obligations and outlays. If the billings are made after the end of the accounting period and research to determine the proper appropriations to be charged extends several months into the next accounting period, first- and second-year schedules of budgetary activity may reflect activity outside the scope of the schedule.

To address audit readiness concerns related to shipment obligations and outlays, in September 2013, the DOD Comptroller and the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics), Office for Transportation Policy, established the DOD-wide Transportation Financial Auditability Working Group to facilitate DOD component audit readiness in the department's freight (military equipment and supplies and materials) and personal property (household goods) process areas.[113] The Working Group is approaching the transportation audit readiness issues in two phases: (1) developing an obligation methodology with enterprise guidance based on FIAR requirements and input from financial management function representatives and (2) achieving overall improvements in transportation processes, systems, and controls. The DOD Comptroller reviewed and approved an obligation methodology to provide direction on establishing policies and procedures for managing transportation transactions funded with bulk estimated obligations.

In July 2014, the Transportation Working Group distributed the obligation methodology to the Army, the Navy, the Marine Corps, the Air Force, U.S. Transportation Command, DLA, and DFAS. The obligation methodology was intended to provide a baseline for DOD components, including the military services, DLA, and U.S. Transportation Command, to develop and refine corrective action plans in preparation for the audits of their fiscal year 2015 schedules of budgetary activity.

Overall transportation business function improvements focus on long-standing transportation financial issues across DOD that require in-depth process analysis and development of standard processes and procedures across the department. The first six focus areas relate to management of transportation account code usage from obligation to payment.[114] The remaining focus areas, which cover information systems, bill payment and expenditure processes, and key supporting documentation, will begin in fiscal year 2015. Efforts to improve business processes, establish business rules (i.e., policy), and achieve systems integration are expected to be completed in fiscal year 2019 or 2020, to support sustainment of auditability. While these are important efforts, until DOD components and service agencies implement effective processes and controls to ensure that shipment obligations and outlays are recorded to the proper fiscal years, they will face significant challenges in audits of their schedules of budgetary activity and, ultimately, their SBRs.

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[113]Under the Integrated Process Team, the Transportation Working Group includes leadership officials from all military services, DLA; U.S. Transportation Command; and other Office of the Secretary of Defense offices, including Installation and Logistics; Logistics Plans, Policies and Strategic Mobility; and Strategy, Capabilities, Policy, and Logistics.

[114]Transportation account codes are used in place of obligation document numbers and chargeable accounting lines (i.e., appropriation account and related budget and project coding).

Conclusions

The unqualified opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule initially reported by the DOD OIG was not supported by sufficient audit procedures or sufficient, appropriate audit evidence. Specifically, the OIG did not (1) perform sufficient procedures to determine the completeness of transactions reported on the Marine Corps' Fiscal Year 2012 General Fund Schedule, (2) perform sufficient procedures to determine the reliability of certain evidence used to support transactions in the Marine Corps' Schedule, (3) perform sufficient procedures to determine whether budget activity was recorded in the proper period and whether shipment obligations were properly recorded, and (4) properly consider and evaluate the audit evidence in concluding and reporting on the result of the audit. As a result, the OIG did not obtain sufficient, appropriate evidence to support the reported audit opinion. Further, the DOD OIG lacked policy and procedures for resolving disagreements among the audit team and documenting the basis for the resolution of such disagreements.

The OIG withdrew its opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule because of issues identified in the audit of the Marine Corps' Fiscal Year 2014 General Fund Schedule that raised questions concerning the completeness of transactions in the Fiscal Year 2012 Schedule on which its opinion was based. At that time, the OIG indicated that once additional information has been gathered and analyzed, the fiscal year 2012 audit opinion will be revisited in light of its analysis and reissued. In commenting on our report, the OIG stated that it would consider all relevant information, including the findings and recommendations in our report and the findings of the four ongoing audits of suspense accounts as well as a report from the OIG's Quality and Standards Office before deciding whether to reissue an opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule.

The Marine Corps made limited progress on resolving uncorrected financial management weaknesses. Consequently, inadequate risk management efforts will likely pose continuing challenges to its auditability. Moreover, the concerns identified with the Marine Corps audit also pose significant challenges to DOD-wide audits because the other military services and DOD components rely on many of the same supporting agencies' business processes and feeder systems to carry out their missions and operations. For example, unless DOD and the military services can provide assurance of (1) completeness of general ledger data and the populations of budgetary transactions used in audit testing, along with proper cutoff and reporting of transactions to the appropriate fiscal year; (2) reliability of financial data generated by DOD agencies' business processes and systems; and (3) proper recording of obligations and outlays, they will be unable to generate auditable schedules of budgetary activity and ultimately auditable sets of financial statements. The ultimate goal of financial audits is to provide accountability over DOD's vast resources along with reliable information to support management decisions on DOD's missions and operations. Achieving a clean audit opinion would be a normal outcome of sound financial management systems, processes, and controls.

Recommendations for Executive Action

To improve the quality of DOD's financial statement audits and ensure that corrective actions to address audit recommendations are fully and effectively implemented prior to their closure, we are making the following three recommendations to the Department of Defense Inspector General:

- In addition to analyzing additional information related to the withdrawal of the auditor's opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule, reconsider the conclusions made in the OIG's initial audit report based on the findings in our report before determining whether the auditor's opinion should be reissued or revised, or whether additional work should be performed.
- Develop and document a quality assurance process for elevating disagreements between the audit team and OIG management to ensure appropriate, objective resolution of the disagreements.
- Ensure that Marine Corps corrective actions fully address audit recommendations and document auditor review of the actions taken before closing the related recommendations.

Agency Comments and Our Evaluation

We provided a draft of this report to the DOD OIG, the Marine Corps, and the Office of the DOD Comptroller. We received written comments from each of these entities, which are reprinted in appendixes II through IV, respectively. We summarize and evaluate the OIG's, Marine Corps', and Office of the DOD Comptroller's comments below, and we provide detailed responses to the OIG's comments following the comment letter in appendix II. We made technical corrections and clarifications in the body of our report, where appropriate.

DOD OIG Comments and Our Evaluation

In commenting on our report, the DOD OIG agreed with our three recommendations directed to it but generally disagreed with our findings that the OIG did not perform sufficient procedures, under professional standards, and consequently did not obtain sufficient, appropriate audit evidence to support its audit opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule. The OIG stated that it believed its report was supported when it was issued on December 20, 2013. The OIG provided comments on (1) the use of professional judgment, (2) completeness of transactions, (3) reliability of evidence, (4) cutoff testing, (6) reliability of recorded obligations, (7) materiality and audit conclusions, and (8) resolution of differences within the audit team. The OIG also commented on our oversight of the Marine Corps' fiscal years 2012 through 2014 audits.

During our review of the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule, we had numerous discussions with the OIG, beginning at the end of February 2013, regarding the key areas discussed in our report. In drafting our report, we carefully considered the responses to our concerns that the OIG provided during these discussions. Such OIG responses were generally consistent with the OIG's written comments on our draft report. Accordingly, the OIG's comments do not raise issues that we had not already considered and appropriately addressed in our work. Further, our findings are consistent with the requirements in professional auditing standards cited in our report.

In addition, the OIG referred, in several places, to additional procedures applied in the audits of the Marine Corps' Fiscal Years 2013 and 2014 General Fund Schedules. The OIG stated that certain audit testing in subsequent audits was expanded to address GAO concerns. We understand that the results of subsequent, expanded audits may provide additional insights into risks and the extent of any misstatements that may exist in the key areas discussed in our report. However, our findings in this report are focused on the adequacy of audit procedures applied and documented as part of the OIG's audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule.

Use of Professional Judgment

The OIG commented that auditing standards recognize that the auditor needs to make professional judgments throughout the audit. We acknowledge that auditing standards recognize the need for professional judgment in conducting an audit. However, auditing standards also include requirements that the auditor needs to fulfill in order to comply with such standards. Auditor requirements in the standards are clearly denoted with the terms “must,” “is required to,” and “should.”[115]

Our report includes references to the relevant requirements in auditing standards and the basis for our determination that in certain key audit areas, the OIG did not perform sufficient procedures, under such standards, and consequently did not obtain sufficient, appropriate audit evidence to support its audit opinion on the Marine Corps’ Fiscal Year 2012 General Fund Schedule. Specifically, we found that the OIG did not

- perform sufficient procedures to determine the completeness of transactions reported on the Marine Corps’ Schedule,
- perform sufficient procedures to determine the reliability of certain evidence used to support transactions included on the Schedule,
- perform sufficient procedures to determine whether budgetary activity was recorded in the proper period and shipment obligations were properly recorded, and
- properly consider and evaluate the audit evidence in concluding and reporting on the results of the audit.

As stated in our report, had sufficient audit procedures been performed in key areas of concern that we identified, additional misstatements may have been identified that when aggregated with already identified misstatements, could be material to the Marine Corps’ Fiscal Year 2012 General Fund Schedule.

Completeness of Transactions

The OIG stated that in its professional judgment, it reduced the risk of material misstatement related to completeness of outlays and obligations to an acceptable level. In our report, we noted several areas where, in our view, there is a high risk of material misstatement related to completeness of outlays and obligations and provided the supporting reasons (e.g., ineffective processes and controls, material amounts involved, and known prior misstatements). As noted in our report, auditing standards require that the auditor design and perform audit procedures to

[115]AU Section 120, *Defining Professional Requirements in Statements on Auditing Standards*, para. .04. The terms “must” and “is required to” identify mandatory requirements and the term “should” identifies presumptively mandatory requirements that the auditor is required to comply with except in rare circumstances in which the auditor documents (1) the justification for the departure and (2) how the alternative procedures performed in the circumstances were sufficient to achieve the objective of the presumptively mandatory requirement.

reduce the risk of material misstatement to an acceptably low level. Also, such standards require that the auditor(1) assess the risk of material misstatement at the relevant assertion level and (2) perform substantive procedures for all relevant assertions related to material classes of transactions, account balances, and disclosures to determine whether there is evidence of any material misstatements. Auditing standards further state that existence and completeness are always relevant assertions.

We found that the OIG did not perform sufficient procedures to determine whether (1) material amounts of fiscal year 2012 obligations and outlays were improperly charged to fiscal year 2011 and prior appropriations, and (2) all nonpayroll feeder system transactions (representing about half of the reported fiscal year 2012 budgetary activity) were properly included in the Marine Corps' Fiscal Year 2012 General Fund Schedule.

The OIG also mentioned that the March 23, 2015, withdrawal of its unqualified opinion report on the Marine Corps' Fiscal Year 2012 General Fund Schedule was not related to the completeness concerns discussed in our report. However, our concerns related to the risk that all transactions that should have been included in the Marine Corps' Fiscal Year 2012 General Fund Schedule were not included in the Schedule, which includes the risk that suspense account transactions were not appropriately included in the Marine Corps' Schedule.

Reliability of Evidence

In response to our finding that the OIG did not perform sufficient procedures to determine the reliability of certain evidence used to support transactions in the Marine Corps' Fiscal Year 2012 General Fund Schedule, the OIG stated that it believes that audit evidence used to test the Schedule was appropriate and permissible under the auditing standards. As discussed in our report, auditing standards require that in examining evidence supporting a transaction, the auditor should consider the reliability of the information used as audit evidence, such as electronic documents, including consideration of controls over its preparation and maintenance, where relevant.[116] Such consideration would normally include any information that raises doubts about the reliability of the evidence. If the auditor has doubts about the reliability of information to be used as audit evidence or is aware of problems with the reliability of

[116]AU Section 326, *Audit Evidence*, para. 09.

the data, the auditor should determine what modifications or additions to the audit procedures are necessary to resolve the issues. Also, when the auditor uses entity-produced information in performing audit testing or procedures to support audit testing, the audit standards require that the auditor obtain evidence about the accuracy and completeness of the information, for example, by performing procedures to determine whether the related controls over the data are effective.[117]

As noted in our report, the auditors did not document their consideration of the reliability of the audit evidence provided by other DOD agencies, although there was evidence that should have raised doubt about the reliability of the audit evidence. In addition, the auditors relied on support produced by certain Marine Corps systems without obtaining sufficient evidence about the accuracy and completeness of this information.

Cutoff Testing

The OIG commented that it believed that the cutoff testing performed on outlays was both sufficient and in accordance with auditing standards. While the OIG comments described certain cutoff tests that were performed, the OIG, as discussed in our report, did not (1) sufficiently document its assessment of the risk of material misstatement related to cutoff, (2) perform sufficient cutoff testing procedures with respect to certain risks (e.g., fiscal year 2012 appropriation transactions that may be inappropriately recorded as fiscal year 2011 transactions), and (3) perform sufficient cutoff testing procedures with respect to certain types of transactions (e.g., transactions with known long transaction cycles). Consequently, there may be misstatements related to cutoff that would not have been detected by the OIG's audit procedures. As noted above, auditing standards require that the auditor design and perform audit procedures to reduce the risk of material misstatement to an acceptably low level.

The OIG also stated that the risk of material misstatement related to cutoff was low, based on the results of the audits of the Marine Corps' fiscal years 2011, 2012, and 2013 (first quarter) budgetary activity. Further, the OIG stated that additional procedures performed during the fiscal years 2013 and 2014 audits did not indicate there was a high risk of material misstatement. In our view, there was a high risk of material

[117]AU Section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, para. .14, and AU Section 326, *Audit Evidence*, para. .10.

misstatement related to cutoff for the reasons included in our report and the fact that cutoff testing was not performed in prior year audits. While we agree that subsequent audits may provide additional information for understanding the risk of material misstatement related to cutoff, we believe that certain cutoff risks were not adequately addressed during the fiscal year 2012 audit. Also, we do not believe that the documentation adequately addressed the auditor's assessment of the risk of material misstatement, including any other considerations beyond the information documented in the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule.

Reliability of Recorded Obligations

The OIG commented that it believes that sufficient audit procedures were performed to determine whether the accounting estimate for transportation shipments was reasonable in the context of the Schedule taken as a whole. As discussed in our report, the audit documentation showed that the OIG had identified several audit risks associated with the Marine Corps' accounting for shipment transactions. For example, the Marine Corps (1) did not have sufficient documentation available to support its multiple obligation processes for shipment transactions and (2) was unable to match the liquidations (outlays) with corresponding obligations. The audit documentation also showed that the OIG had attempted to perform substantive detail testing of the Marine Corps' shipment obligations; however, the Marine Corps was unable to provide support for $231.5 million of its reported $529.5 million in fiscal year 2012 shipment obligations.

As stated in our report, auditing standards identify procedures that the auditor may consider when reviewing and testing the process used to develop management's estimates, including controls over the process and the relevance, reliability, and sufficiency of historical data used in the estimate.[118] The OIG commented that it had performed four of the nine procedures enumerated in the auditing standards. In addition, the auditing standards state that the auditor's objective is to obtain sufficient, appropriate evidence to provide reasonable assurance that the accounting estimates are reasonable in the circumstances.[119] In assessing the reasonableness of an estimate, auditing standards state that the auditor normally concentrates on key factors and assumptions

[118]AU Section 342, *Auditing Accounting Estimates*, para. .11.

[119]AU Section 342, *Auditing Accounting Estimates*, paras. .07 and .08.

that include sensitivity to variations, deviations from historical patterns, susceptibility to misstatements and bias, and the entity's historical experience related to the reliability of prior year estimates.[120] As stated in our report, the audit documentation did not contain evidence that the OIG sufficiently performed certain other procedures enumerated in the auditing standards that we believe are important related to (1) identifying whether there were controls over the preparation of the accounting estimates and supporting data that may be useful in the evaluation and (2) considering whether sources of data and factors that management used in forming the assumptions were relevant, reliable, and sufficient for the purpose of determining the estimates based on information gathered in other audit tests.[121]

Materiality and Audit Conclusions

The OIG stated that it believes the results of the audit work were properly considered and that it appropriately evaluated the audit evidence in accordance with all applicable auditing standards to conclude and report on the results of the audit of Marine Corps' Fiscal Year 2012 General Fund Schedule. The OIG stated that its calculation of misstatements related to errors and untested amounts totaled approximately $773 million. The OIG also stated that all known misstatements or known risk factors were appropriately considered. The OIG stated that even if it included the $35.8 million that we reported related to unsupported contract payment transactions, the revised misstatements would total approximately $808.8 million, which is still below the overall materiality threshold of $826 million that the OIG had established for the audit.

As discussed in our report, auditing standards state that in evaluating whether the financial statements are presented fairly, in all material respects, in conformity with GAAP, the auditor must consider the effects, both individually and in the aggregate, of misstatements (both known and likely) that are not corrected by the entity.[122] At the conclusion of the audit, the auditor accumulates identified misstatements and considers whether such misstatements are material to the entity's financial statements. Auditing standards further state that as the aggregate misstatement approaches materiality, the risk that the financial

[120] AU Section 342, *Auditing Accounting Estimates*, para. .09.

[121] AU Section 342, *Auditing Accounting Estimates*, para . 11a. and 11b.

[122] AU Section 312, *Audit Risk and Materiality in Conducting an Audit*, para. 50.

statements could be materially misstated also increases; consequently, the auditor should consider the effect of undetected misstatements, in concluding on whether the financial statements are fairly stated.[123] Because the OIG's previously noted calculation of misstatements totaling $773 million represents nearly 94 percent of its $826 million materiality threshold for the audit, in accordance with auditing standards, the OIG should have determined an amount for undetected misstatements and included this amount in its materiality calculation for concluding on the results of the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule. However, the OIG did not do so.

Further, had sufficient audit procedures been performed in the key areas of concern that we identified, additional misstatements may have been identified that, when aggregated with already identified misstatements, could be material to the Marine Corps' Fiscal Year 2012 General Fund Schedule. Consequently, in the absence of such additional procedures, we do not believe that the OIG obtained sufficient, appropriate evidence to reduce the risk of material misstatement to an appropriately low level.

Resolution of Differences within the OIG Audit Team

The OIG agreed with our recommendation that it develop and document a quality assurance process for elevating disagreements between the audit team and OIG management to ensure appropriate, objective resolution of the disagreements. The OIG also stated that it was developing a formalized process for elevating such disagreements.

GAO Oversight and Timely Input

The OIG commented that we did not always provide timely input on the results of our oversight of the OIG's audits of the Marine Corps' Fiscal Years 2012 and 2013 General Fund Schedules and that the OIG was encouraged by the interaction that took place between GAO and the OIG as part of the audit of the Marine Corps' Fiscal Year 2014 General Fund Schedule. For the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule, we provided comments to the OIG as we identified issues and concerns about its audit. For example, on May 1, 2013, when the OIG was in the process of concluding on the fiscal year 2012 audit results, we informed the OIG that audit procedures were not performed to test cutoff, and that cutoff is a key assertion that must be tested to provide audit evidence related to the completeness of transactions included in financial statements for the period audited. On May 30, 2013, the OIG

[123] AU Section 312, *Audit Risk and Materiality in Conducting an Audit*, paras. .41 and .65.

made a decision to include cutoff as one of the additional areas it planned to test in its audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule. In addition, as the OIG has noted, audit testing was expanded in subsequent audits based on the concerns we identified with the fiscal year 2012 Marine Corps audit.

Marine Corps Comments and Our Evaluation

The Marine Corps agreed overall with our discussion of actions needed on the issues related to the audit of its fiscal year 2012 General Fund Schedule. However, the Marine Corps did not agree with certain findings with respect to (1) support for certain audit sample items, and (2) progress in addressing audit recommendations. We acknowledge the Marine Corps' continuing efforts to improve accountability over its financial management systems and internal controls.

Support for Certain Sample Items

The Marine Corps stated that although the OIG may have deliberated with it on requiring an additional cutoff sample of 334 outlay transactions, the Marine Corps was not issued the additional samples and was not asked to provide supporting documentation. The discussion in our report is supported by the OIG's audit documentation and a discussion with the auditors. Our review of the OIG's audit documentation found that on September 6, 2013, the OIG e-mailed two, separate statistical samples for cutoff testing of obligations and outlays to the Marine Corps and requested that the Marine Corps provide the requested supporting documentation by close of business on September 13, 2013. The audit documentation shows that the Marine Corps responded to the obligation sample. However, OIG auditors told us that Marine Corps officials advised them that they could not respond to the request for additional fiscal year 2012 outlay samples because Marine Corps staff was responding to samples for the fiscal year 2013 Marine Corps audit, and sufficient staff were not available to respond to samples from both audits.

Progress in Addressing Audit Recommendations

The Marine Corps acknowledged that much work remains to fully mitigate its internal control weaknesses. However, the Marine Corps commented that it does not agree with our assertion that significant, uncorrected control weaknesses continue to impair the Marine Corps' ability to produce consistent, reliable, and sustainable financial information for day-to-day decision making on its missions and operations. The objective of internal control is to provide reasonable assurance of (1) the effectiveness and efficiency of the entity's operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations. An operating environment with significant, uncorrected weaknesses in internal controls lacks this assurance. In addition, the nature of the Marine Corps' material weaknesses in internal control, which the OIG reported, include (1) financial management systems that do not comply with FFMIA requirements related to compliance with GAAP for federal government entities and the USSGL and (2) ineffective financial management oversight with regard to identifying and correcting accounting errors. The existence of such material weaknesses demonstrates that the Marine Corps does not have reasonable assurance of the reliability of its financial management operations.[124]

Further, the Marine Corps stated that in addition to the 11 accounting and financial reporting recommendations that were closed by the OIG, it had remediated an additional 17 accounting and financial reporting recommendations and was awaiting validation testing from the OIG or an audit firm. The Marine Corps also stated that based on reinforced coordination with its information technology stakeholders and testing through the completion of the audit of its Fiscal Year 2014 Schedule, 94 of 95 information technology system recommendations were remediated. We have not assessed the corrective actions taken subsequent to the December 20, 2013, issuance of the audit report on the Marine Corps' Fiscal Year 2012 General Fund Schedule and our update in August 2014.

Office of the DOD Comptroller Comments and Our Evaluation

The Office of the DOD Comptroller generally agreed with the findings in our report related to DOD-wide audit readiness implications and summarized efforts that are planned or under way to test controls over business processes and financial-related systems to help ensure the reliability of data used for DOD financial audits. However, the Office of the DOD Comptroller stated that our report does not recognize many of the corrections and improvements made by the Marine Corps or the value of lessons learned from the Marine Corps audits. We acknowledge DOD's continuing efforts to become audit ready.

Our report includes several examples where the DOD Comptroller and its FIAR Team had developed appropriate audit readiness guidance several years ago to help DOD components and mission support agencies, such

[124]A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

as DLA, effectively respond to requirements under professional auditing standards in their audit readiness efforts. Our report also states that certain DOD components, such as the mission support agencies, have not followed the FIAR Guidance regarding audit readiness timelines for supporting DOD components with regard to assuring that their own processes, systems, and controls are effective and can be relied on to support their DOD customers' audits. To the extent that the other DOD military services and DOD agencies rely on these support agencies, they are likely to experience similar challenges as the Marine Corps with regard to having reliable information for decision making on their missions and operations and achieving auditability of their budgetary information.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the appropriate congressional committees, the Secretary of Defense, the DOD Inspector General, the Under Secretary of Defense (Acquisition, Technology and Logistics); the Under Secretary of Defense (Comptroller)/Chief Financial Officer; the Deputy Chief Financial Officer; the Under Secretary of Defense (Personnel and Readiness); the Director of the Defense Finance and Accounting Service; the Director for Financial Improvement and Audit Readiness; the FIAR Governance Board; the Assistant Secretaries (Financial Management and Comptroller) of the Army, the Navy, and the Air Force; the Commandant of the Marine Corps; the Director of the Office of Management and Budget; and other interested parties. In addition, the report will be available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-9869 or khana@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff members who made key contributions to this report are listed in appendix V.

Asif A. Khan
Director, Financial Management and Assurance

Appendix I: Objectives, Scope, and Methodology

Our objectives were to (1) determine the extent to which the audit was performed in accordance with professional auditing standards; (2) analyze the status of the Marine Corps' actions to address identified accounting, financial reporting, and information technology system control weaknesses; and (3) identify any implications to the Department of Defense (DOD) based on the Marine Corps' Fiscal Year 2012 General Fund Schedule of Budgetary Activity (General Fund Schedule) audit results.

To address our first objective, we analyzed auditor documentation, test results, and conclusions to determine the extent to which the work complied with professional auditing standards. As our criteria, we used professional audit standards issued by the American Institute of Certified Public Accountants, which are consistent with generally accepted government auditing standards, and considered additional guidance in the GAO/President's Council on Integrity and Efficiency *Financial Audit Manual*.[1] We followed the guidance in Section 650 of the *Financial Audit Manual* for relying on the work of others. We reviewed the Marine Corps' Office of Inspector General (OIG) audit contracts and statements of work and the Marine Corps' management representation letters, which contain assertions about the reliability of its financial reporting in accordance with generally accepted accounting principles, related to the audits of the Marine Corps' Fiscal Year 2012 General Fund Schedule and its Fiscal Years 2011 and 2010 General Fund Statements of Budgetary Resources. In addition, we reviewed the OIG Marine Corps Auditor Reports, including the audit opinions, and Reports on Internal Control and Compliance with Laws and Regulations as well as the auditor's reports to Marine Corps management that included detailed auditor findings and recommendations, and the Marine Corps' responses to the auditor's reports.

We also reviewed the audit documentation related to planning, executing, concluding, and reporting on the audit. We retested selected auditor sample items for significant classes of transactions, such as civilian and

[1]GAO and President's Council on Integrity and Efficiency, *Financial Audit Manual*, vol. 1, GAO-08-585G (Washington, D.C.: July 2008). The President's Council on Integrity and Efficiency was disestablished by the Inspector General Reform Act of 2008, Pub. L. No. 110-409, § 7 (Oct. 14, 2008), which instead established the Council of the Inspectors General on Integrity and Efficiency as an independent entity within the executive branch.

military payroll, unpaid obligations related to undelivered orders and delivered orders, and outlays (payments or liquidations of the orders received) to determine if we agreed with the auditors' conclusions on tests of those sample items. Throughout our audit, we discussed the concerns we identified regarding the conduct of the audit with OIG and independent public accounting firm auditors, including concerns about (1) completeness of reported budgetary transactions, (2) the reliability of data generated by DOD feeder systems, (3) proper fiscal year cutoff and the reliability of reported shipment obligations, and (4) the auditors' conclusions on the audit as well as the basis for auditor judgments made during the audit.

To analyze the status of the Marine Corps' actions to address audit recommendations on identified accounting, financial reporting, and information technology system control weaknesses, we used federal internal control standards as our criteria.[2] We assessed the status of the Marine Corps' corrective actions on recommendations from the Marine Corps' fiscal years 2010 through 2012 audits. We met with Marine Corps officials to discuss corrective action plans and actions completed and under way as well as their process for monitoring corrective actions. We reviewed auditor support for closed recommendations to determine whether the (1) corrective actions had been appropriately designed to address reported weaknesses and (2) documentation on closed recommendations confirmed that actions to address them had been completed.

To identify any DOD-wide implications of the Marine Corps' Fiscal Year 2012 General Fund Schedule audit results, we considered our findings with regard to the conduct of the Marine Corps audit and the status of Marine Corps actions to address auditor recommendations as well as November 2014 *Financial Improvement and Audit Readiness (FIAR) Plan Status Report* information on the status of DOD military service and DOD mission support agency audit readiness efforts.[3] We gave particular consideration to audit readiness issues we identified with regard to assuring the (1) completeness of populations and proper cutoff,

[2]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

[3]Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, *Financial Improvement and Audit Readiness (FIAR) Plan Status Report* (November 2014).

(2) reliability of financial data and information generated by DOD business processes and feeder systems, and (3) reliability of reported obligations and outlays. We considered whether DOD agencies and the other military services relied on many of the same systems, processes, and controls as the Marine Corps and would be likely to experience similar issues in their audits.

We conducted this performance audit from July 2012 through July 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Department of Defense Office of Inspector General

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

MAY 22 2015

Mr. Asif A. Khan, Director
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW Mailstop 5Q24
Washington, DC 20548

Dear Mr. Khan:

This is in response to GAO draft report GAO-14-198, DOD Financial Management: Actions Are Needed on Audit Issues Related to the Marine Corps' 2012 Schedule of Budgetary Activity dated April 22, 2015 (GAO Code 197123).

We appreciate the opportunity to comment on the audit that the Government Accountability Office (GAO) performed on the DoD OIG audit of the United States Marine Corps (USMC) FY 2012 Schedule of Budgetary Activity (SBA). The DoD OIG is dedicated to supporting GAO in their audit of the Government-wide financial statements. We concur with the three recommendations contained in the report.

GAO RECOMMENDATIONS AND DOD OIG RESPONSE

1. GAO Recommendation: In addition to analyzing additional information related to the withdrawal of the auditor's opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule of Budgetary Activity, reconsider the conclusions made in the OIG's initial audit report based on the findings in our report before determining whether the auditor's opinion should be reissued or revised, or whether additional work should be performed.

DoD OIG Response: Concur. While we believe that the original opinion report was supported when we issued it on December 20, 2013, we have continued to meet with GAO to better understand their preferences and interpretation of standards for how financial statement audits should be executed across DoD. The Inspector General will consider all relevant information including the findings and recommendations of this report, the findings of the four ongoing audits of the suspense accounts, as well as a soon to be completed report from the OIG's Quality and Standards Office before deciding if or when to reissue an opinion on the Marine Corps Fiscal Year 2012 Schedule of Budgetary Activity.

2. GAO Recommendation: Develop and document a quality assurance process for elevating disagreements between the audit team and OIG management to ensure appropriate, objective resolution of the disagreements.

DoD OIG Response: Concur. We are currently developing a policy that will be added to our audit handbook. We will ask that GAO review the policy prior to implementation.

3. GAO Recommendation: Ensure that Marine Corps corrective actions fully address audit recommendations and document auditor review of the actions taken before closing the related recommendations.

DoD OIG Response: Concur. We will ensure that IPAs are in compliance with GAGAS requirements for tracking and closing recommendations. Our practice has been to continually follow up on the previous year's open recommendations as part of the current year audit. Often prior year recommendations were closed and then slightly modified and reissued to reflect the level of progress that was made during the year. While we have procedures for reviewing, testing, and documenting the results of corrective actions taken by the auditee prior to closing recommendations, we will ensure that all ongoing and future DoD audits have well documented procedures for recording the status of recommendations made and any corrective actions taken.

While we concur with the three recommendations, we offer the following management comments on the report findings.

Professional Judgment

The GAO/PCIE Financial Audit Manual (FAM) recognizes the need to use professional judgment when conducting financial statement audits. This manual uses the phrase "professional judgment" 49 times and the phrase "auditor judgment" an additional 18 times. For example, the GAO/PCIE FAM 110.23 states that auditors must use professional judgement and exercise professional skepticism in evaluating the quantity and quality of audit evidence. In addition, for both internal controls and substantive testing, the GAO/PCIE FAM sections110.25, 310, and 420 requires the use of professional judgement in evaluating the risks of material misstatement; planning the audit to address the risks identified; and developing the nature, timing, and extent of tests to be performed. The GAO/PCIE FAM sections 540 and 580 also requires the use of professional judgement in not only evaluating misstatements, but also in concluding on the audit procedures and reporting the results to management. It is our professional judgment that the FY 2012 USMC audit appropriately considered and applied these audit standards and the related guidance in the GAO/PCIE FAM. As noted above, we will consider the results of our ongoing suspense account audits, this report from GAO and other ongoing IG reports prior to deciding if or when to reissue the opinion.

Throughout the report, GAO references several auditing standards, but does not mention the need to use professional judgment when applying each of these standards. For example, while the report quotes paragraph 6 of AU Section 326, *Audit Evidence,* the report omits paragraph 13 which states "The auditor should use professional judgment and should exercise professional skepticism in evaluating the quantity and quality of audit evidence, and thus its sufficiency and appropriateness, to support the audit opinion." The report also implies that the auditing standards provide detailed descriptions of the specific procedures an auditor should perform in conducting a financial statement audit. There are numerous instances in the report

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where GAO states "typical testing would include …" However, there are no authoritative citations to either the FAM or audit standards to support these assertions because neither the audit standards nor the FAM prescribe the level of testing that must be performed. Both audit standards and the FAM are intentionally general in nature because they appropriately recognize the need for the auditor to determine whether sufficient procedures have been performed to support the audit opinion that is issued.

In all phases of the audit, the standards explicitly state that auditor judgment is needed to determine the type of test that will be performed, when the testing is to be conducted, how much testing is to be done, and how the test results are to be interpreted. For example, AU Section 230, *Due Professional Care in the Performance of Work,* states auditor judgment is involved regarding the areas to be tested and the nature, timing, and extent of the tests to be performed. AU Section 230 also states that judgment is required in interpreting the results of audit testing and evaluating the audit evidence. Further, AU Section 350, *Audit Sampling,* states that auditors are required to use professional judgment in planning, performing and evaluating both nonstatistical and statistical samples and in forming a conclusion based on the evidence provided for the sample. AU 318.75, *Performing Audit Procedures in Response to Assessed Risk and Evaluating the Audit Evidence Obtained,* states the sufficiency and appropriateness of audit evidence to support the auditor's conclusions throughout the audit are a matter of professional judgment.

See comment 1.

Auditing Standard No. 8, Audit Risk, states, "[t]o form an appropriate basis for expressing an opinion on the financial statements, the auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to error or fraud. Reasonable assurance is obtained by reducing audit risk to an appropriately low level through applying due professional care, including obtaining sufficient appropriate audit evidence." With an unlimited amount of time, an auditor can perform exhaustive testing procedures trying to eliminate audit risk beyond a reasonable level. We believe the FY 2012 USMC audit appropriately balanced the risk that a material misstatement would not be detected and the need to produce a timely report that was relevant to the Department. Throughout GAO's nearly 3 year effort to evaluate the FY 2012 USMC audit, GAO did not identify any material misstatements that were excluded from our conclusions. In this case, an unqualified audit opinion would be appropriate because the schedule was not materially misstated and was presented in accordance with applicable accounting principles.

Group Auditing

GAO is the auditor for the Government-wide financial statements and, in our view, is the de facto group auditor for Government-wide financial statement audits. We recognize GAO's authority under the group auditing standards and will continue to make every effort to support their audit of the Government-wide financial statements. As oversight partners, we will continue to encourage GAO to take an active role in the DoD financial statement audits. We welcome timely feedback and input when GAO's preferences on the nature, timing and extent of audit procedures differ from what the OIG or IPA auditors intend to execute.

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Throughout the FY 2012 and FY 2013 audits, GAO auditors who were providing oversight did not always provide timely input. We are encouraged by the progress that was made in the FY 2014 audit and look forward to this being the foundation for all future DoD financial statement audits where GAO provides oversight. Because we want GAO to rely on our audit work, we value GAO's advice and experience. As a result, we expanded the level of testing in both the FY 2013 and 2014 audits and will remain mindful of their preferences and interpretations of audit standards in our future work.

During the FY 2014 audit, the level of communication between the audit teams of GAO, the OIG, and the IPA have improved with GAO participating in extensive meetings to discuss the IPA's audit approach. Agreements were reached that addressed GAO's preferences and interpretations of standards. Since the entrance conference for the FY 2014 USMC SBA audit, DoD OIG audit management and the IPA firm have been engaged in frequent discussions with GAO and repeatedly requested feedback on whether GAO agreed that the audit approach was in accordance with auditing standards and GAO's preferences.

Completeness of Transactions

The GAO report states that OIG did not perform sufficient procedures to determine the completeness of transactions reported on the Marine Corps' Fiscal Year 2012 General Fund Schedule

DoD OIG Response: We do not agree with the report findings that our audit lacked sufficient procedures to assess the completeness of transactions to determine the reliability of certain evidence, and whether budgetary activity was recorded in the proper period. We believe the FY 2012 audit properly considered and evaluated the audit evidence. Each of these audit areas requires a significant level of professional judgment. During the audit, more than 5,600 transactions were evaluated by the DoD OIG and Independent Public Accounting (IPA) firm auditors to determine whether they were properly recorded on the USMC SBA. In addition, numerous other tests, including tests of the significant IT systems were also performed. While we acknowledge that some of the audit decisions could have been documented better, the FY 2012 USMC SBA audit met professional standards. However, because GAO had previously expressed preferences about some aspects of the testing conducted during the FY 2012 audit, we expanded the level of testing and documentation in the FY 2013 audit and further expanded this effort again during the FY 2014 audit to address GAO's preferred approach. This additional analysis showed that the USMC recorded outlays in an average of 17 days. This average time was shorter than our 30-day cut-off testing period, and supports that our 30 day cut-off testing period was sufficient.

We acknowledge that the GAO report describes some possible ways to test the completeness of the FY 2012 Schedule. However, audit standards do not prescribe that these are the only acceptable approaches and allow other alternative approaches, including those that we used to assess the completeness of transactions included on the FY 2012 schedule. Because of challenges obtaining documentation to support older transactions, the Department limited the

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FY 2012 SBA to just current year transactions. Accordingly, we limited our testing to only FY 2012 appropriations because these transactions were the primary focus of the audit effort.

During the audit, we performed various risk assessments for each account, performed testing of detailed transactions for completeness, and performed multiple reconciliations. Specifically, we performed reconciliations of military payroll disbursements recorded in the Monthly Payroll Reconciliation/Certification Voucher (MRCV) to the USMC general ledger system, (referred to as the Standard Accounting, Budgeting, and Reporting System SABRS); civilian payroll disbursements recorded in the Defense Civilian Payroll System (DCPS) to SABRS; and reserve payroll disbursements recorded in MRCV to SABRS. In addition, we tested abnormal balances to determine if there were unrecorded obligations. We also performed testing of the SABRS unmatched files and traced the totals to the SBA to provide additional assurance the USMC's disbursements were fairly presented. We validated that the SABRS data file agreed to the SABRS trial balance; and that the SABRS trial balance agreed to the Defense Departmental Reporting Systems (DDRS) unadjusted trial balance (UTB) and that the DDRS UTB tied to the SBA to provide assurance over the completeness of the SBA. Finally, we performed year-end cut-off testing to provide assurance that transactions were recorded in the appropriate period. In our professional judgment, based on the totality of these auditing procedures, we reduced the risk of material misstatement related to completeness of outlays and obligations to an acceptable level.

See comment 2.

Figure 3 on page 14 of the GAO draft report is incomplete. The figure indicates that rejected transactions are removed from SABRS with no process to eventually include the corrected transactions into SABRS. In addition, the GAO's narrative indicates that USMC personnel were not actively analyzing and correcting the rejected transactions. Both Figure 3 and the related narrative could mislead readers of this report. Although there was not a formal policy in place in FY 2012, USMC was actively reviewing, analyzing, and correcting rejected transactions. We documented our understanding of the USMC process in the audit workpapers that GAO reviewed.

See comment 3.

The GAO report expressed concern that we did not complete a full comparison of FY 2012 SABRS transaction activity to the FY 2012 Fund Balance with Treasury reconciliation to assist in providing assurance over completeness of budgetary transactions. Although this is an acceptable testing procedure to gain assurance over completeness, it is not a required audit procedure. We obtained an understanding of the cross-disbursement process and the reconciliation performed by USMC for this process. Further, we traced selected transactions to the reconciliation and documented our understanding. Although we believe the FY 2012 audit work was sufficient, we understand the preferences GAO had regarding completeness testing. To further reduce audit risk, we performed additional Fund Balance with Treasury control procedures during our FY 2013 and FY 2014 USMC SBA audits to address GAO's concerns and noted no material misstatements from these additional audit procedures.

The completeness concern discussed in the March 23, 2015, DoD OIG memo withdrawing the FY 2012 USMC SBA unqualified opinion report was not related to system interface concerns raised by GAO. The OIG withdrew its FY 2012 USMC SBA opinion, in accordance with AU Section 561, because subsequently discovered facts regarding suspense

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accounts identified during the FY 2014 audit caused us to question the completeness of the information on which we based our FY 2012 opinion. While we were aware that USMC transactions were contained in Navy and other DoD suspense accounts during the FY 2012 USMC SBA audit, the available information during the audit indicated that the scope of transactions did not pose a risk of material misstatement or a need to test the transactions in suspense accounts as a separate population. However, the FY 2014 auditors obtained new information during the audit that demonstrated a higher risk associated with DoD transactions contained in Treasury suspense accounts. Through discussions with USMC and DFAS personnel about the nature and quantity of transactions posted in these suspense accounts, the auditors determined enough uncertainty existed to question the completeness of the FY 2012 Schedule. Because this problem has DoD-wide implications, we announced a comprehensive audit on May 1, 2015, "Audit of the DoD Suspense Accounts" (Project No. D2015-D000FE-0186.000). This audit will specifically address the challenges that the Army, Navy, Air Force and Defense Agency suspense accounts pose to the ongoing audits of the SBA as well as future audits of the full financial statements.

See comment 4.

As explained above, because of the challenge in obtaining documentation to support older transactions, the Department limited the FY 2012 SBA to only current year transactions. Accordingly, we limited our testing to only FY 2012 appropriations. The GAO report contends that a risk of material misstatement exists related to transactions recorded in FY 2012 to prior year appropriations that USMC should have charged to FY 2012 appropriations. Specifically, the report states that over $3.8 billion in FY 2012 outlay activity was recorded to prior fiscal year appropriations. This information overstates the risk to the FY 2012 SBA because the outlay activity in FY 2012 would include charges to one-year appropriations, as well as multi-year appropriations. In addition, due to the types of products and services USMC purchases, outlays on one-year appropriations can be made up to 5 years after the initial obligation. Therefore, it is expected that USMC would have significant outlays to prior year appropriations during FY 2012. However, the FY 2012 SBA audit appropriately excluded these transactions because the schedule only included current year appropriations. In addition, the FY 2012 audit addressed the risk that GAO mentions. Specifically, during first quarter testing for both FY 2012 and FY 2013, we did not identify any material transactions that were recorded in the wrong fiscal year or posted to the wrong appropriation. As a result of FY 2011, FY 2012, and FY 2013 testing we determined the risk of recording transactions in the incorrect period was low.

The report also concluded that there was a risk of a material amount of feeder system data not included in the USMC general ledger even though the extensive work GAO performed did not identify any material transactions that were omitted from the SBA. During our audit, we tested over 5,600 transactions and concluded that the FY 2012 UMSC SBA was materially correct. This conclusion was supported by over 12,000 documents, emails, position papers and auditor workpapers that were provided to GAO. Although we believe the work completed in FY 2012 was sufficient, we understand the concerns the GAO has presented and their preferred audit approach. As a result, we performed additional procedures during our FY 2013 audit and the IPA also performed additional testing during the FY 2014 USMC SBA audit to address GAO's preferences and interpretations of the audit standards, including expanded cut-off testing and additional system interface testing to ensure transactions were properly posted to the USMC

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accounting system. Both of these expanded audit efforts did not identify any material transactions in feeder systems that were inappropriately omitted from the USMC general ledger.

Summary of OIG actions to address GAO's concerns:

1. To address GAO concerns about the length of the cut-off period that we selected, during the FY 2013 and 2014 audits we performed further analysis on the amount of time that USMC normally needed to record disbursement transactions.

2. To address concerns about the reliability of certain evidence, we increased our review of sample transactions that the contracted-IPA initially reviewed. In FY 2013, we used statistical methods in determining the number of sample transactions to review. This increased level of effort verified that sufficient and reliable evidence was provided by USMC and assessed by the IPA. For the FY 2014 audit, the IPA further modified the audit procedures to include testing of error reports resulting from USMC's processing of transactions from feeder systems. This testing specifically addressed GAO's concern about the completeness of significant USMC feeder data.

3. Additional deliverables are being incorporated into future contracts to address concerns raised by the GAO regarding the completeness of IT feeder systems.

Reliability of Evidence

The GAO report states that OIG did not perform sufficient procedures to determine the reliability of certain evidence used to support transactions in the Marine Corps Schedule

DoD OIG Response: We believe that audit evidence used to test the USMC schedule was appropriate and permissible under audit standards. We considered the USMC as a standalone reporting entity and not a DoD component. Using this approach, we developed audit procedures that considered USMC's business partners to be vendor-type relationships. We anticipated addressing any DoD problems not directly attributable to, or unique to, the USMC during other DoD component level audits. However, the GAO report implies that all cross-cutting problems within DoD should be fully remediated by every component level audit (or before any component-level audits are started).

See comment 5.

Audit standards and the FAM permit both internal and external evidence to be used to support the auditors' conclusions, but the auditor must use professional judgment in evaluating the quality of the evidence. Both Auditing Standard No. 15 (which superseded AU Section 326 for audits of fiscal years beginning on or after December 15, 2010) and GAO/PCIE FAM section 470 discuss the types of evidence and generalizations about the quality of the types of evidence available. For instance, evidence obtained from a knowledgeable source that is independent (external evidence) is generally more reliable than evidence obtained only from internal company sources (internal evidence).

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See comment 5.

Based on the audit approach, we do not consider information obtained from the Defense Logistics Agency (DLA) and U.S. Transportation Command to be internal evidence. Rather, based on the guidance in Auditing Standard No. 15, GAO/PCIE FAM section 470, and conclusions reached after reviewing AT Section 801, "Reporting on Controls at a Service Organization" and AU-C 402, "Audit Considerations Relating to an Entity Using a Service Organization," we considered DLA and U.S. Transportation Command to be business vendor of USMC. This conclusion was appropriate since USMC maintained control over authorizing the transactions flowing through these activities and also was responsible for the accountability of these transactions. Further, USMC management lacked the ability to influence or exercise direct control over decisions and budgets of these separate agencies. Therefore, information obtained from agencies and Commands independent from USMC would be considered corroborating external evidence. An example of appropriate evidence to review from a third party vendor, as suggested in FAM 470 is "invoices for expenses and the purchase of inventory and property." During the audit, we did not receive any information that raised significant doubts about the third party information that would preclude its use as sufficient and appropriate audit evidence to support the FY 2012 USMC SBA.

See comment 6.

The GAO report expresses concern about the reliability of feeder system data. The report contends that we should have performed additional procedures on the external evidence obtained because there was other information that should have raised doubt about its reliability. Specifically, the GAO report notes that DoD reported DLA MILSTRIP as a department-wide material weakness in its FY 2012 Agency Financial Report. Although we agree that there are weaknesses surrounding MILSTRIP processes, the FY 2012 Agency Financial Report does not conclude that the data within the system is unreliable. Additionally, the reported weaknesses would not prevent the auditors from using the MILSTRIP information to complete the audit tests. Specifically, we used the information from DLA MILSTRIP to corroborate internal information received from USMC. For example, we used the Logistics Data Gateway (LDG) report from the MILSTRIP process to verify the total cost and date an order was placed (obligation), received, and paid (outlay). We also reviewed the LDG report for the type of item ordered, the quantity ordered, received, and paid, unit price, mathematical accuracy, and for returns that were not recorded in SABRS.

To address the concerns that GAO raised about the reliability of certain evidence used, we increased our review of sample transactions that the contracted-IPA initially reviewed. During the FY 2013 audit, we used statistical methods in determining the number of sample transactions to review. This increased level of effort verified that sufficient and reliable evidence was provided by USMC and assessed by the IPA. For the FY 2014 audit, the IPA further modified the audit procedures to include testing of error reports resulting from USMC's processing of transactions from feeder systems. This testing specifically addressed GAO's concern about the completeness of significant USMC feeder data. In addition, during the FY 2014 audit, the IPA performed additional audit procedures to obtain a more thorough understanding of the DLA MILSTRIP business process. These additional procedures did not result in any significant concerns or change the auditors prior conclusions about the reliability of the evidence used to support USMC transactions processed through MILSTRIP.

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See comment 7.

It is important to note that audit standards do not require an SSAE No. 16 examination of systems information so that the results can be used to corroborate data from another entity. Because USMC was not relying solely on DEAMS to send information directly to DDRS for financial statement reporting on behalf of USMC, consistent with audit standards, we did not require an SSAE No. 16 examination or conduct additional testing of the information that was outside the scope of the audit. Additionally, the DoD OIG report on DEAMS was not relevant to the information obtained from DEAMS because the report did not specifically address data quality. Rather, this report addressed DEAMS managers not maintaining an adequate Chart of Accounts (COA) and DEAMS not reporting financial data directly to DDRS. Although there were financial reporting concerns identified, the audit did not determine that the information in DEAMS was unreliable. Therefore, the DEAMS audit results did not prevent us from relying on the information contained in DEAMS. Our use of the information obtained from DEAMS to corroborate information obtained from USMC was both appropriate and allowable under the audit standards.

See comment 8.

Although we issued a disclaimer of opinion on DoD's department-wide financial statement for FY 2012, that audit effort did not include any tests of the DEAMS or MILSTRIP data that was used to corroborate the USMC transactions. Under Section 1008 of the 2002 National Defense Authorization Act, the DoD IG is required to limit its audit procedures unless DoD management asserts that it is ready for audit. Because the Department had not asserted that its DoD-wide financial statements were auditable, this audit report was based on minimal audit procedures to support the disclaimer. As a result, there was no direct connection between the results of the DoD-wide financial statement audit report and the audit of the USMC SBA for FY 2012.

The FY 2012 USMC SBA was compiled using transactions contained in the USMC accounting system and general ledger. We considered this information to be the initial evidence received to support the SBA. During testing of specific sample transactions, the evidence obtained from the third parties was used to confirm that USMC accurately recorded the transactions in the accounting system. Therefore, in accordance with Auditing Standard No. 15 and GAO/PCIE FAM sections 420 and 470, we appropriately considered all types of audit evidence and the reliability of that evidence when evaluating and concluding on audit procedures performed.

Summary of OIG additional actions to address GAO concerns:

1. To address the concerns raised about the reliability of certain evidence used, we increased our review of sample transactions that the contracted-IPA initially reviewed. In FY 2013, we used statistical methods in determining the number of sample transactions to review.

2. With respect to external evidence from USMC business partners, during the FY 2014 audit, the IPA performed additional audit procedures to obtain a more thorough understanding of the DLA MILSTRIP business process.

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3. To further consider the risks discussed by the GAO report, OIG is planning future audits of MILSTRIP and USTRANSCOM information to determine whether it is sufficiently reliable evidence for use in financial statement audits.

4. For the FY 2015 audit, additional deliverables are being incorporated into the IPA contract to address concerns raised by the GAO regarding the reliability of IT feeder system data.

Cut-off testing

The GAO report states that OIG did not perform sufficient procedures to determine whether budget activity was recorded in the proper period and whether shipment obligations were properly recorded

DoD OIG Response: Auditing standards do not prescribe a specific amount of time that is appropriate for cut-off testing. We believe that the FY 2012 USMC audit appropriately considered the analyses of the business processes and results of testing that was performed. However, we acknowledge that the audit documentation could have more clearly explained our judgment in establishing a cut-off testing period of 30 days. As documented in our audit workpapers, we considered audit results from FY 2011, FY 2012 and FY 2013 (first quarter) as a basis for our cut-off testing period and procedures. Although the FY 2011 statistical testing of obligations identified 6 transactions that USMC should have recorded in FY 2010, the Marine Corps recorded a year end adjustment to account for this error. During first quarter testing for both FY 2012 and FY 2013, we did not identify any material transactions that were recorded in the wrong fiscal year or posted to the wrong appropriation. As a result of FY 2011, FY 2012, and FY 2013 testing, we determined the risk of recording transactions in the incorrect period was low. After considering all these audit procedures, we determined cutoff testing for one month after year-end would be sufficient.

Because of the preferences that GAO presented, we performed additional analysis in FY 2013 to determine the average time an outlay took to post to the general ledger. On average, outlays reviewed by the DoD OIG took approximately 17 days from the day it was paid until it was recorded in the general ledger. In addition, the auditors significantly extended the FY 2014 cut-off testing until February 2015. Consistent with the FY 2012 and 2013 cut-off testing results, no material amount of transactions were inappropriately recorded in the wrong fiscal year or posted to the wrong appropriation.

See comment 9.

While we agree with GAO that some transactions may be recorded in the wrong period, neither the additional analyses performed during the FY 2013 and FY 2014 audits nor the factors that the GAO report presented support the conclusion that there was a high risk of a material amount of transactions recorded in the wrong fiscal year. Although there were some DoD-wide transactions that were recorded in the improper period, USMC did not report any instances and we did not identify any material instances where USMC recorded transactions in an improper period. While the GAO report correctly states that obligations for transportation charges have

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been a challenge for the Army, Navy, and Air Force, USMC developed an estimate to counter the risks that GAO presented. Additionally, the draft report is misleading when stating, "the DoD OIG was aware the Marine Corps was performing analysis of approximately $21 million of shipment billing in January 2013—4 months after the end of the fiscal year—to determine the extent of adjustments needed to record the related outlay transactions to fiscal year 2012 and prior year appropriations." GAO auditors were present during a series of meetings to assess this situation and they were made aware that, out of the $21 million mentioned in the GAO report, only approximately $1 million was adjusted to record the outlay in a prior fiscal year appropriation. During the FY 2012 audit, we performed several audit procedures on the adjustments the GAO mentioned. After these analyses, we determined any amount that may have been adjusted would be immaterial to the schedule taken as a whole.

It is important to note the context of the statement OIG auditors made about cut-off errors that could be identified during the FY 2013 audit that would require a restatement for the FY 2012 SBA. The draft report omits a critical fact that FY 2012 cut-off testing was ongoing at the same time as the FY 2013 audit. Thus, the test results of the FY 2013 audit could be used to inform the ongoing FY 2012 audit. Since similar testing for first quarter FY 2013 had already been completed for the FY 2013 audit, there would be no reason to perform duplicative testing. The OIG audit staff was trying to communicate to GAO that if material misstatements were noted in the FY 2013 testing, we would consider those results in the conclusions for the FY 2012 opinion. As noted in the FY 2013 testing, we did not have significant errors related to cut-off, including the transactions recorded against FY 2013 appropriations.

See comment 10.

We believe the cut-off testing performed on outlays was both sufficient and in accordance with audit standards. For outlay cut-off testing, the initial testing results noted seven exceptions. In further testing, the auditors were able to trace four of the exceptions to the SABRS unmatched file, which was then traced to the SBA to ensure those transactions were included in the final outlays presented. Therefore, it was appropriate to conclude that those four transactions were not exceptions. We obtained additional details for the three remaining exceptions and were able to determine that they were correctly excluded from the SBA since the outlay did not occur until the next fiscal year. The 14 other transactions were supported by evidence obtained from DLA, an agency external to the USMC, to corroborate the information provided by USMC.

We also believe that sufficient audit procedures were performed to determine whether the accounting estimate for transportation shipment was reasonable in the context of the schedule taken as a whole. While the GAO report presented two options available under AU Section 342, there are a total of nine procedures that auditors may consider when assessing the reasonableness of an accounting estimate and there is no requirement in the standards to perform all nine procedures. As part of our assessment of the shipping obligation estimate, we performed four of the nine procedures outlined in the audit standards. Specifically, we (1) identified sources of data and determined whether such data and factors were relevant, reliable, and sufficient for estimation; (2) evaluated whether the assumptions were consistent with supporting data and relevant historical data; (3) reviewed available documentation of the assumptions made by management; and (4) tested the calculations used by management to translate the assumptions and key factors into the estimated shipping obligations. Based on our understanding of the

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estimate, we determined historic liquidations were the relevant data used in calculating the accounting estimate. We performed various analyses of the historic liquidations to assess the reliability of outlay transaction data used for determining obligation liquidation rates, including:

- Analytics to determine the reliability of the historic liquidations for FY 2008, FY 2009, FY 2010, FY 2011, and FY 2012;
- Use of detailed transaction data from prior audit coverage, the detailed transaction data from FY 2012, and the detailed transaction data from the FY 2013 audit coverage to recreate the liquidation populations;
- Verifying that the summarized liquidations presented on the USMC estimate agreed with the USMC detailed liquidation data files; and
- Testing for liquidations in FY 2010, FY 2011, and FY 2012 to determine if USMC recorded the correct liquidation amount per the detailed vouchers.

In reviewing the estimate and gaining an understanding of the factors and assumptions management made when developing the estimate of the shipping obligations, we considered the impact of different types of shipment outlay rates. USMC developed a risk assessment applying this concept. The process was documented in the Universe and Adjustment Methodology written and provided by USMC.

Overall, we considered and documented the risk related to some of the reliability and completeness testing and decided to perform multiple additional tests to determine the overall reasonableness of the estimate of the shipment obligations. As a result of the audit procedures performed, we determined that obligations as recorded were overstated by approximately $53.7 million and recommended that USMC make an adjustment. USMC agreed with the analysis and made the adjustment. Based on the totality of the audit procedures we performed, we concluded that there was sufficient and appropriate evidence that the accounting estimate of the shipment obligations reported on FY 2012 USMC SBA was reasonable.

Summary of OIG additional actions to address GAO concerns:

1. To address GAO concerns about the length of the cut-off period that we selected, during the FY 2013 audit we performed further analysis on the amount of time that USMC normally needed to record disbursement transactions.
2. During the FY 2014 USMC audit, the IPA significantly expanded cut-off testing into March 2015.
3. With respect to shipment obligations, in both the FY 2013 and 2014 audits, we assessed USMC's shipping obligation estimate using four of the nine options in AU section 342.

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See comment 11.

Materiality and Conclusions

The GAO report states that OIG did not properly consider and evaluate the audit evidence in concluding and reporting on the results of the audit.

DoD OIG Response: We believe that the results of the audit work were properly considered and that we appropriately evaluated the audit evidence in accordance with all applicable audit standards to conclude and report on the FY 2012 USMC SBA results. As noted above, we will consider the results of our ongoing suspense account audits, this report from GAO and other ongoing IG reports prior to deciding if or when to reissue the opinion. During the FY 2012 audit, all known misstatements or known risk factors were appropriately considered. We performed both a quantitative and qualitative assessment when concluding and reporting the results of the audit. In doing the final quantitative risk assessment, we calculated the materiality exposure for each line item of the SBA and included the audit precision which resulted in misstatements related to errors and untested amount of approximately $773 million. Although we disagree with the GAO conclusion that we did not include all known misstatements, if we did include the additional misstatements GAO reported, the revised misstatements related to errors and untested amounts would be approximately $808.8 million which is still below the overall materiality threshold of $826 million. While the report states that "further misstatement may exist," no examples of material or immaterial misstatements were provided as examples to support this assertion. Therefore, because the schedule was materially correct, and the total materiality threshold was not exceeded, an unqualified opinion was appropriate.

The GAO draft report states that we made an assumption that the unsupported outlay transactions could be an adjustment and reported as advance payments to avoid counting the amounts as untested. While we agree with GAO that USMC may not always properly record certain progress payment transactions, we specifically obtained evidence that an outlay occurred related to a valid obligation. Therefore, for purposes of the SBA, the balance of gross outlays on the face of the Schedule would be unaffected by these compliance issues. The compliance issue was reported to USMC in FY 2010 and has continued to be reviewed and updated as necessary. In addition, the Report on Internal Control and Compliance with Laws and Regulations associated with the FY 2012 USMC SBA audit opinion appropriately discusses the lack of sufficient internal controls to ensure the proper recording of contract-progress-payment transactions.

In addition to the quantitative calculations, we also reviewed several qualitative factors including: the relationship between the USSGL accounts and its impact of misstatements in individual accounts versus the impact on the overall SBA; Congressional and public interest; and open findings and recommendations and the impact on the reliability of the information presented in the SBA. Although we concluded the qualitative factors did not affect the overall presentation of the SBA, we did include information in the report to discuss those factors that may affect the USMC as they move to full financial statement audits. For example, we added an explanatory paragraph to the audit opinion to alert the reader that some transactions were not correctly recorded in the underlying general ledger accounts. We explained the misstatements did not have an effect on the fair presentation of the Schedule, but future audits of the full

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Statement of Budgetary Resources or the other financial statements, such as the Balance Sheet, could be adversely affected by these errors.

See comment 12.

We agree with GAO that technical support from the DoD OIG Quantitative Methods Division (QMD) is key in providing auditors assistance in determining the appropriate population so that audit results are defensible. However, we disagree with the report statement that QMD expressed no opinion regarding the projection of the results. Although, QMD expressed some concern with the statistical methods used by the IPA auditors, it is important to note that QMD confirmed that the statistical projections were calculated accurately and signed the certification. The draft report omits this key point.

While we agree with the GAO draft report that we could have more clearly documented the auditor judgments made in determining the audit opinion; we believe the audit documentation shows a clear timeline of the decision making process and the workpapers documenting the testing demonstrated those decisions. For example, as of September 6, 2013 we initially concluded based on the results of cutoff testing that we were unable to gain assurance of the completeness of populations for the Obligations Incurred and Outlays line items on the SBA. However, additional audit procedures and follow-up effort cleared the exceptions or resulted in a proposed adjustment to the SBA Obligations Incurred line item. The GAO draft report does not reflect this additional work that was performed.

Based on the totality of the work performed, we believe that alternative auditing procedures successfully addressed concerns related to the completeness of populations used for testing historical shipment liquidation transactions that were not addressed as part of the audit. Although we did not have access to historical unadjusted trial balances for FY 2008 and FY 2009, we performed additional testing of historic liquidations to make informed conclusions. We also performed substantive analytical procedures to determine the reliability of the historic liquidations for FY 2008, FY 2009, FY 2010, FY 2011, and FY 2012; and we verified that the summarized liquidations presented on the USMC estimate agreed with the USMC detailed liquidation data files to gain sufficient assurance over the historic liquidations.

Summary of OIG additional actions to address GAO concerns

For all future opinions issued by the DoD OIG, we are developing a comprehensive decision paper template that will fully document criteria and audit results that support the conclusions and OIG decisions for determining the appropriate audit opinion to issue.

Resolving Differences of Opinion

We agree with GAO that audit organizations should establish policies and procedures for addressing and resolving differences of opinion within the engagement team. Throughout the audit, the most experienced auditors who were Certified Public Accountants were involved in key decisions. Any formal escalation process to resolve disagreements amongst the team and management would have involved these same senior leaders. However, based on the recommendation of this report, we are developing a formalized process for elevating

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disagreements between audit teams and management. We are currently drafting revisions for our audit handbook that will specifically address how differences of opinion amongst team members and between team members and senior leaders will be resolved. Prior to finalizing these revisions, we will share this with GAO and incorporate any observations they may have.

In conclusion, we appreciate the opportunity to review and comment on the draft GAO report. As indicated above, in our professional judgment, the FY 2012 audit of the USMC SBA was performed in accordance with applicable audit standards. As noted previously, we will consider the results of our ongoing suspense account audits, this report from GAO, and other ongoing IG reports prior to deciding if or when to reissue the opinion. In addition, because of the concerns that GAO raised during their review of the FY 2012 audit, additional audit procedures were performed during the FY 2013 and 2014 audits. Implementing the proposed recommendations in this report will help ensure that GAO will be able to rely on future audits as part of their audit of the Government-wide consolidated financial statement audit.

Daniel R. Blair

Daniel R. Blair, CPA
Deputy Inspector General
for Auditing

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The following are GAO's comments on the Department of Defense (DOD) Office of Inspector General (OIG) letter dated May 22, 2015.

GAO Comments

1. **Material misstatements.** The OIG stated that we did not identify any material misstatements that were excluded from its conclusions on the audit. It was not our objective to audit the Marine Corps' Fiscal Year 2012 General Fund Schedule of Budgetary Activity (General Fund Schedule). Consequently, we did not perform audit tests to determine whether material misstatements occurred. As stated in our report, the OIG did not perform sufficient audit procedures, under professional standards, and consequently did not obtain sufficient, appropriate evidence to support its opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule of Budgetary Activity (General Fund Schedule). Had sufficient audit procedures been performed in key areas of concern that we identified, additional misstatements may have been identified that when aggregated with the already identified misstatements, could be material to the Marine Corps' Fiscal year 2012 General Fund Schedule.
2. **Rejected transactions.** The OIG stated that figure 3 in our draft report indicated that rejected transactions were removed from the Standard Accounting, Budgeting and Reporting System (SABRS) with no process to eventually include corrected transactions in SABRS. Because figure 3 depicts feeder system data flow, we revised the arrow related to the flow of rejected transactions to show that, if handled correctly, the rejected transactions would be corrected and, entered into SABRS. However, as discussed in our report, the OIG did not perform sufficient procedures to reasonably assure that rejected transactions were properly resolved and entered into SABRS before closing a related audit recommendation.
3. **Reconciliation of SABRS to Fund Balance with Treasury.** The OIG stated that we expressed concern that it did not complete a full comparison of fiscal year SABRS transaction activity to the Marine Corps' fiscal year 2012 Fund Balance with Treasury reconciliation. The OIG stated that such a comparison is an acceptable procedure for gaining assurance of completeness, but it is not a required audit procedure. We referred to such testing as an example of one of the types of audit procedures that may be performed to determine whether recorded transactions are complete.

   The OIG also stated that it had traced selected transactions to the reconciliation. However, as stated in our report, these procedures would not be effective for testing completeness of transactions recorded in SABRS because they begin with items that are already recorded in SABRS.

4. **Fiscal year 2012 activity recorded to fiscal year 2011 appropriations.** The OIG stated that our example of $3.8 billion in Marine Corps fiscal year 2012 outlays that was recorded to fiscal year 2011 appropriations as reported by the Department of the Treasury, overstated the risk to the Marine Corps' Fiscal Year 2012 General Fund Schedule. The OIG stated that the Marine Corps fiscal year 2012 outlay activity would include charges to 1-year appropriations as well as multiyear appropriations. We specifically excluded multiyear appropriations in calculating the $3.8 billion amount in our example. We included this example in our report because it illustrates that the amount of such transactions charged to prior year appropriations was material. As stated in our report, we believe the risk of material misstatement to the Marine Corps' Fiscal Year 2012 General Fund Schedule related to transactions recorded in fiscal year 2012 to prior year appropriations that should have been charged to fiscal year 2012 appropriations is high based on numerous reported Marine Corps' weaknesses in controls over accounting and financial reporting and the magnitude of fiscal year 2012 Marine Corps' outlays that were recorded to prior fiscal year appropriations. Accordingly, testing of such transactions was necessary to determine whether there were any material misstatements.

   In addition, the OIG stated that the audit of the Marine Corps' Fiscal Year 2012 Schedule appropriately excluded fiscal year 2012 transactions recorded to fiscal year 2011 because the Schedule only included current year appropriations. However, the scope of a first-year audit of a schedule of budgetary activity would appropriately include a determination of whether transactions related to current fiscal year appropriations were improperly charged to prior year appropriations, and, therefore, improperly excluded from the schedule.

5. **Consideration of DOD agencies as third parties.** The OIG stated that the auditing standards permit the use of both internal and external evidence and state that evidence from a knowledgeable source that is independent is generally more reliable than evidence obtained only from internal sources. Further, the OIG stated that based on its audit approach, it does not consider information obtained from the Defense Logistics Agency (DLA) and U.S. Transportation Command to be internal evidence. Instead, the OIG considered these DOD agencies to be third parties with respect to the Marine Corps. As stated in our report, in examining evidence supporting a transaction, the auditor

should consider the reliability of the information used as audit evidence, such as electronic documents, including consideration of controls over its preparation and maintenance where relevant.[1] Such consideration would normally include any information that raises doubts about the reliability of the evidence. If the auditor has doubts about the reliability of information to be used as audit evidence or is aware of issues with the reliability of the data, the auditor should determine what modifications or additions to the audit procedures are necessary to resolve the issues. Also, as discussed in our report, there were well-known, documented issues that should have raised significant doubts about the reliability of the data from DLA and U.S. Transportation Command systems and processes that the OIG relied on in its transaction testing for the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule.

6. **Military Standard Requisitioning and Issue Procedures (MILSTRIP) material weakness.** The OIG stated that although it agrees that there are weaknesses surrounding MILSTRIP processes, DOD's fiscal year 2012 Agency Financial Report does not conclude that the data within the system is unreliable and that the reported weaknesses would not prevent the auditors from using the MILSTRIP information to complete the audit tests. We disagree. As discussed in our report, DOD reported DLA's MILSTRIP process as a department-wide material weakness, stating that the department could not effectively account for transactions and balances in the MILSTRIP orders process. Because this and other factors should have raised doubts about the reliability of MILSTRIP process data, auditors should determine what modifications or additions to the audit procedures are necessary to resolve the issues.
7. **Relevance of OIG report on Defense Enterprise Accounting and Management System (DEAMS).** The OIG stated that auditing standards do not require a Statement on Standards for Attestation Engagements (SSAE) No. 16 examination of system information in order for the results to be used to corroborate data from another entity and that the Marine Corps did not rely solely on DEAMS for its financial statement reporting. However, the concern raised in our report was that the OIG used information from DEAMS as audit evidence and DEAMS had known data reliability issues. As discussed above, if there are doubts about the reliability of information to be

[1] AU Section 326, *Audit Evidence*, para. .09.

used in audit testing, auditors should determine what modifications or additions are needed to the audit procedures to resolve the issues.

8. **Relevance of disclaimer on DOD financial statements.** The OIG stated that although it issued a disclaimer on DOD's department-wide financial statements for fiscal year 2012, its audit effort on the department-wide statements did not include any tests of DEAMS or MILSTRIP data that were used to corroborate the Marine Corps transactions. The OIG stated that as a result, there was no direct connection between the results of the DOD department-wide financial statement audit report and the audit of the Marine Corps' Fiscal Year 2012 General Fund Schedule. As discussed in our report, in disclaiming an opinion on DOD's department-wide financial statements for fiscal year 2012, the OIG reported that DOD financial management and business feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2012.[2] The well-known, documented issues related to these systems should have raised significant doubts about the reliability of the data used in testing and the OIG should have determined what modifications or additions were needed to the audit procedures to resolve the issues.
9. **Reallocation of shipment outlays.** The OIG stated that it agrees with us that some transactions may be recorded in the wrong period, although the Marine Corps did not report and the OIG did not identify any material instances where the Marine Corps recorded transactions in an improper period. As discussed in our report, the OIG's audit documentation did not include evidence that the OIG performed any procedures to (1) test the accuracy of the Marine Corps' allocation of fiscal year 2012 shipment billings to previous fiscal year appropriations or (2) confirm that the related adjustments were recorded to ensure that the portion of the outlays that pertained to previous fiscal year appropriations, and in some cases, other military services, were excluded from the outlays reported on the Marine Corps' Fiscal Year 2012 General Fund Schedule.

   The OIG also stated that our draft report was misleading regarding the discussion of $21 million of fiscal year 2012 shipment billings the Marine Corps was analyzing in January 2013 to determine the extent

[2]Department of Defense, Office of Inspector General, *Independent Auditor's Report on the Department of Defense FY 2012 and FY 2011 Financial Statements*, DODIG-2013-021 (Alexandria, VA: Nov 15, 2012).

of adjustments needed to the Marine Corps reported fiscal year 2012 outlays. The OIG stated that our auditors were present during a series of meetings to assess this situation. The meetings the OIG referred to were held in November and December 2014, which was after the OIG had issued its opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule.

10. **Cutoff control testing on outlays.** The OIG stated that it was able to resolve 7 transactions that its initial testing had determined were exceptions (errors) and that the other 14 transactions were supported by evidence obtained from DLA, an agency external to the Marine Corps. We revisited Marine Corps documentation that was available for 18 of the 21 transactions and determined that the additional support was sufficient for 6 of the 18 transactions. We revised the discussion in our report accordingly. However, because support for the other 12 transactions was not sufficient, we continue to believe that controls over cutoff for outlays were not effective and the OIG should have performed substantive detail tests of cutoff for outlays.

11. **Adjustments to progress payment transactions.** The OIG stated that while the Marine Corps may not always properly record certain progress payment transactions the OIG obtained evidence that an outlay occurred related to a valid obligation. The OIG stated its position that for purposes of the Marine Corps' Fiscal year 2012 General Fund Schedule, if support for progress payment outlays could not be obtained, adjusting the outlay transaction to an advance payment would have no net effect on the Marine Corps' schedule. The OIG stated that it considered such occurrences as a compliance issue. However, as stated in our report, the audit documentation showed that the audit team had initially determined that it could not conclude on the accuracy of sampled contract outlay transactions for which there was no support that the goods and services paid for were received. More specifically, the audit documentation showed that the audit team could not determine the validity of certain progress payment obligations because the contract information provided to them by the Marine Corps did not contain sufficient detail to make such a determination. Further, the audit documentation showed that the tested contractor invoices were related to progress payments and the audit team had determined that progress payments should not be recorded as advances. The audit team planned to include the unsupported contract obligations and outlays in its overall calculation of misstatements. The audit documentation also showed that OIG management subsequently made an assumption that the unsupported outlay transactions could be adjusted and reported as advance payments to avoid counting the amounts as untested. As stated in our

report, the audit documentation did not include a reconciliation or explanation for such conflicting statements between OIG management and the audit team.

12. **Quantitative Methods Division (QMD) certification.** The OIG commented that it disagreed with the discussion in our report regarding QMD's certification of statistical sampling and stated that although QMD expressed some concern with the statistical methods used by the audit firm, QMD confirmed that the statistical projections were calculated accurately and signed the certification. As stated in our report, we reviewed the documentation on QMD's certification and held discussions with QMD statisticians regarding reasons why they added a note that qualified their certification. Specifically, the note stated that QMD expresses no opinion as to the application of results with respect to the evaluation of the sample results against materiality. QMD officials told us that they qualified their certification because the auditors mixed two methods for making statistical estimates, QMD was not included in the materiality assessment process, and as a result, they did not know the basis for the auditor judgments that were made. QMD officials also told us that this was unusual and that they are generally included in auditor assessments of materiality to help the auditors interpret sampling results.

Appendix III: Comments from the United States Marine Corps

DEPARTMENT OF THE NAVY
HEADQUARTERS UNITED STATES MARINE CORPS
3000 MARINE CORPS PENTAGON
WASHINGTON, DC 20350-3000

IN REPLY REFER TO:
5200
R
20 May 15

From: Fiscal Director of the Marine Corps
To: Government Accountability Office (GAO)

Subj: MANAGEMENT COMMENTS TO THE GAO DRAFT REPORT GAO-15-198, ACTIONS ARE NEEDED ON AUDIT ISSUES RELATED TO THE MARINE CORPS' 2012 SCHEDULE OF BUDGETARY ACTIVITY

1. Unless otherwise noted, these management comments only address the Marine Corps specific issues included in the report section titled "The Marine Corps Has Not Taken Timely Actions to Address Identified Accounting, Reporting, and System-related Internal Control Weaknesses." Overall, we concur with this section of the GAO report regarding Marine Corps actions needed on audit issues related to the United States Marine Corps' Schedule of Budgetary Activity (SBA) for Fiscal Year (FY) 2012, but we provide the following management comments.

2. Cutoff Testing of Outlay Transactions (Page 28). The report inaccurately states that "...the OIG subsequently requested that the Marine Corps provide documentation for a sample of 334 outlay transactions for substantive testing of end-of-period cut-off. However, the Marine Corps responded that it was unable to provide support..." In fact, the Marine Corps successfully supported two separate cutoff tests of 105 samples each. Although DoDIG personnel may have deliberated requiring an additional cutoff sample of 334 transactions, the Marine Corps was not issued additional cutoff samples to support. Under no circumstance did we decline to support any sample sets that were issued to us.

3. Timely Actions to Address Identified Accounting Reporting, and System-related Weaknesses and Limited Progress in Addressing Internal Control Weaknesses Identified by the OIG (Page 35-41). While the report credits the Marine Corps for improving remediation efforts and strengthening its monitoring process, the Marine Corps does not concur with the assertion that "significant uncorrected control weaknesses continue to impair the Marine Corps' ability to produce consistent, reliable and sustainable financial information for day-to-day decision making on its missions and operations." While we agree with the importance of internal controls, they are but one factor that

Subj: MANAGEMENT COMMENTS TO THE GAO DRAFT REPORT GAO-15-198, ACTIONS ARE NEEDED ON AUDIT ISSUES RELATED TO THE MARINE CORPS' 2012 SCHEDULE OF BUDGETARY ACTIVITY

contributes to the financial information used for decision making. Even before the Marine Corps began its audit journey, we have been committed to strengthening internal controls and enhancing our business process. The Marine Corps has also focused on modernizing our financial management systems and improving our financial reporting process. Further, the Marine Corps has either initiated or proactively served in many workgroups to improve business processes, identify and mitigate internal control weaknesses, and increase the accuracy, reliability, and timeliness of financial management information.

4. Concerning the progress of addressing internal control weaknesses, GAO report focuses on a baseline of 177 total recommendations issued from the FY 2010 and FY 2011 audits, which resulted in disclaimers of opinion due to inability to complete the audits within available timeframes, and the FY 2012 audit - the first time that all designated audit work was completed. Throughout that time, along with the subsequent completion of the FY 2013 and FY 2014 audit work, we have gained heightened understanding of the interrelationships between some findings and recommendations and recognition that effective corrective actions may differ somewhat from the original recommendations. Consequently, based on the original 82 financial reporting recommendations outlined in Table 2 on page 37 of the report - along with the 11 recommendations closed by DoDIG - we have successfully remediated an additional 17 recommendations and await validation testing from DoDIG or an independent audit firm. Additionally, due to reinforced coordination with our IT stakeholders and testing through the completion of the FY 2014 SBA audit, we successfully remediated 94 of the 95 IT system recommendations.

5. The Marine Corps acknowledges that much work remains to fully mitigate internal control weaknesses. As our audit activity matured and we recognized the need to provide focused attention and leadership on corrective actions, we formally established the Remediation Section within the Risk and Compliance Branch in February 2014. Although the majority of corrective actions must be implemented by the process owners throughout the Marine Corps, the branch is working to establish

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Subj: MANAGEMENT COMMENTS TO THE GAO DRAFT REPORT GAO-15-198, ACTIONS ARE NEEDED ON AUDIT ISSUES RELATED TO THE MARINE CORPS' 2012 SCHEDULE OF BUDGETARY ACTIVITY

appropriate staffing levels to ensure effective orchestration and oversight of all corrective actions, plus the successful development and execution of Internal Controls over Financial Reporting (ICOFR) and Internal Controls over Financial Systems (ICOFS) test plans.

6. Since the January 2014 date in the GAO report, the Marine Corps has increased its resources to execute a more robust controls-based test plan of the Marine Corps-owned systems based on the Federal Information System Control Audit Manual (FISCAM) methodology with a particular emphasis on business process, application level, and interface control objectives. We have also engaged external system owners undergoing or completing Statement on Standards for Attestation Engagements (SSAE) so the Marine Corps can review the test results, ascertain additional control objectives/techniques, and develop test plans for Complementary User Entity Controls (CUEC).

7. Lastly, we concur with the issue noted in the GAO report related to challenges in hiring personnel with the requisite education and experience in financial statement audits or business process or internal control reviews. This is a specialized skill set that is not typically resident in current military or government civilian workforce. Therefore, we continue to explore avenues to hire personnel with these skills and may require special hiring authorities to achieve success.

8. We look forward to working with GAO and other interested parties in future audit and remediation efforts.

Ann-Cecile M. McDermott
A. M. MCDERMOTT

Copy to:
ASN (FM&C)

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Appendix IV: Comments from the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

MAY 21 2015

Mr. Asif A. Khan
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW, Mailstop 5Q24
Washington, DC 20548

Dear Mr. Khan:

Thank you for the opportunity to comment on draft report GAO-15-198, "Actions Are Needed on Audit Issues Related to the Marine Corps' 2012 Schedule of Budgetary Activity." The DoD Office of Inspector General (as auditor and most recently in its oversight role of the independent public accounting firm conducting this audit) and the U.S. Marine Corps (USMC) have been directly involved with this audit. Appropriately, their comments focus on the details of this report. In contrast, the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer and its Financial Improvement and Audit Readiness (FIAR) team have been monitoring this audit for several years. Therefore, my comments will focus on the broader implications the report has on DoD audit readiness.

We agree that accurate reconciliations of transaction universes are critical for accountability, and must include the ability to regularly "tie out" financial feeder systems to the general ledger. Further, an entity under audit must assume ownership of its complete end-to-end business processes carrying financial information and be able to rely on data provided by other service providers acting on behalf of other entities. As highlighted in the May 2015 FIAR Plan Status Report and discussed during monthly updates with you and your team, we have specific ongoing actions to continue identifying and remediating reconciliation deficiencies. For example, we have 19 control audits (Statement on Standards for Attestation Engagements 16) in place or planned to support all impacted DoD organizations, to include the USMC. The DoD business environment is arguably the largest and most complex business environment in the world and much of its complexity results from the many organizations involved in our business processes. While these dependencies provide efficiencies and produce required operational outcomes, their impact on financial auditability is becoming clearer as a result of our audit experience.

The lessons from the USMC audit are an outstanding example of why the audit experience is so important to the Department. Understanding and applying lessons learned from audits directly contributes to the significant auditability progress we are making on this massive change management effort. However, while your report highlights areas for improvement, it does not recognize many of the corrections and improvements already made by the USMC, nor does it constructively mention the value of the audit to the Marine Corps or other organizations who will be applying its lessons. I appreciate that you have always informally acknowledged progress in our regular updates. We look forward to your continued engagement and closer examination of how we have implemented these changes.

I am absolutely convinced of the value of moving DoD organizations to a regular audit regimen as a way to reinforce an improved level of business discipline. The Department is committed to improving the quality of its financial information and achieving auditability. We also commend the U.S. Marine Corps and the Department of the Navy for their leadership in setting the pace for bringing the Department under an audit regimen.

Mark E. Easton
Deputy Chief Financial Officer

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Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Asif A. Khan, (202) 512-9869 or khana@gao.gov

Staff Acknowledgments

In addition to the contact named above, Robert F. Dacey (Chief Accountant), Gayle L. Fischer (Assistant Director), Richard Mayfield (Auditor-in-Charge), Michael Bingham, Gloria Cano, Jeremy Choi, Francine DelVecchio, Doreen Eng, Donald D. Holzinger, Pierre Kamga, Jason Kelly, Jason Kirwan, Richard Larsen, Gregory Marchand (Assistant General Counsel), Quang Nguyen, Brian Paige, Heather Rasmussen, Robert Sharpe, Eric Stalcup, and Ivy Wu made key contributions to this report.

Appendix VI: Accessible Data

Agency Comment Letters

Accessible Text for Comments from the Department of Defense Office of Inspector General

Page 1

Mr. Asif A. Khan, Director

Director, Financial Management and Assurance

U.S. Government Accountability Office 441 G Street, NW Mailstop 5Q24 Washington, DC 20548

Dear Mr. Khan:

This is in response to GAO draft report GA0-14-198, DOD Financial Management: Actions Are Needed on Audit Issues Related to the Marine Corps' 2012 Schedule of Budgetary Activity dated April 22, 2015 (GAO Code 197123).

We appreciate the opp01iunity to comment on the audit that the Government Accountability Office (GAO) performed on the DoD OIG audit of the United States Marine Corps (USMC) FY 2012 Schedule of Budgetary Activity (SBA). The DoD OIG is dedicated to supporting GAO in their audit of the Government-wide financial statements. We concur with the three recommendations contained in the report.

GAO RECOMMENDATIONS AND DOD OIG RESPONSE

1. GAO Recommendation: In addition to analyzing additional information related to the withdrawal of the auditor's opinion on the Marine Corps' Fiscal Year 2012 General Fund Schedule of Budgetary Activity, reconsider the conclusions made in the OIG's initial audit report based on the findings in our report before determining whether the auditor's opinion should be reissued or revised, or whether additional work should be performed.

DoD OIG Response: Concur. While we believe that the original opinion report was supported when we issued it on December 20, 2013, we have continued to meet with GAO to better understand their preferences and interpretation of standards for how financial statement audits should be executed across DoD. The Inspector General will consider all relevant information including the findings and recommendations of this rep01i, the findings of the four ongoing audits of the suspense accounts, as well as a soon to be completed report from the OIG's Quality and Standards Office before deciding if or when to reissue an opinion on the Marine Corps Fiscal Year 2012 Schedule of Budgetary Activity.

2. GAO Recommendation: Develop and document a quality assurance process for elevating disagreements between the audit team and OIG management to ensure appropriate, objective resolution of the disagreements

Page 2

DoD OIG Response: Concur. We are currently developing a policy that will be added to our audit handbook. We will ask that GAO review the policy prior to implementation.

3. GAO Recommendation: Ensure that Marine Corps c01Tective actions fully address audit recommendations and document auditor review of the actions taken before closing the related recommendations.

DoD OIG Response: Concur. We will ensure that IPAs are in compliance with GAGAS requirements for tracking and closing recommendations. Our practice has been to continually follow up on the previous year's open recommendations as part of the current year audit. Often prior year recommendations were closed and then slightly modified and reissued to reflect the level of progress that was made during the year. While we have procedures for reviewing, testing, and documenting the results of corrective actions taken by the auditee prior to closing recommendations, we will ensure that all ongoing and future DoD audits have well documented procedures for recording the status of recommendations made and any corrective actions taken.

While we concur with the three recommendations, we offer the following management comments on the report findings.

Professional Judgment

The GAO/PCIE Financial Audit Manual (FAM) recognizes the need to use professional judgment when conducting financial statement audits. This manual uses the phrase "professional judgment" 49 times and the phrase "auditor judgment" an additional 18 times. For example, the GAO/PCIE FAM 110.23 states that auditors must use professional judgement and exercise professional skepticism in evaluating the quantity and quality of audit evidence. In addition, for both internal controls and substantive testing, the GAO/PCIE FAM sectionsl 10.25, 310, and 420 requires the use of professional judgement in evaluating the risks of material misstatement; planning the audit to address the risks identified; and developing the nature, timing, and extent of tests to be performed. The GAO/PCIE FAM sections 540 and 580 also requires the use of professional judgement in not only evaluating misstatements, but also in concluding on the audit procedures and reporting the results to management. It is our professional judgment that the FY 2012 USMC audit appropriately considered and applied these audit standards and the related guidance in the GAO/PCIE FAM. As noted above, we will consider the results of our ongoing suspense account audits, this report from GAO and other ongoing IG reports prior to deciding if or when to reissue the opinion.

Throughout the report, GAO references several auditing standards, but does not mention the need to use professional judgment when applying each of these standards. For example, while the report quotes paragraph 6 of AU Section 326, Audit Evidence, the rep01i omits paragraph 13 which states "The auditor should use professional judgment and should exercise professional skepticism in evaluating the quantity and quality of audit evidence, and thus its sufficiency and appropriateness, to supp01i the audit opinion." The repo1i also implies that the auditing standards provide detailed descriptions of the specific procedures an auditor should perform in conducting a financial statement audit. There are numerous instances in the report

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where GAO states "typical testing would include ..." However, there are no authoritative citations to either the FAM or audit standards to support these assertions because neither the audit standards nor the FAM prescribe the level of testing that must be performed. Both audit standards and the FAM are intentionally general in nature because they appropriately recognize the need for the auditor to determine whether sufficient procedures have been performed to support the audit opinion that is issued.

In all phases of the audit, the standards explicitly state that auditor judgment is needed to determine the type of test that will be performed, when the testing is to be conducted, how much testing is to be done, and how the test results are to be interpreted. For example, AU Section 230, Due Professional Care in the Performance of Work, states auditor judgment is involved regarding the areas to be tested and the nature, timing, and extent of the tests to be performed.

AU Section 230 also states that judgment is required in interpreting the results of audit testing and evaluating the audit evidence. Further, AU Section 350, Audit Sampling, states that auditors are required to use professional judgment in plam1ing, performing and evaluating both non statistical and statistical samples and in forming a conclusion based on the evidence provided for the sample. AU 318.75, Performing Audit Procedures in Response to Assessed Risk and Evaluating the Audit Evidence Obtained, states the sufficiency and appropriateness of audit evidence to support the auditor's conclusions throughout the audit are a matter of professional judgment.

Auditing Standard No. 8, Audit Risk, states, "[t]o form an appropriate basis for expressing an opinion on the financial statements, the auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to error or fraud. Reasonable assurance is obtained by reducing audit risk to an appropriately low level through applying due professional care, including obtaining sufficient appropriate audit evidence." With an unlimited amount of time, an auditor can perform exhaustive testing procedures trying to eliminate audit risk beyond a reasonable level. We believe the FY 2012 USMC audit appropriately balanced the risk that a material misstatement would not be detected and the need to produce a timely report that was relevant to the Department. Throughout GAO's nearly 3 year effort to evaluate the FY 2012 USMC audit, GAO did not identify any material misstatements that were excluded from our conclusions. In this case, an unqualified audit opinion would be appropriate because the schedule was not materially misstated and was presented in accordance with applicable accounting principles.

Group Auditing

GAO is the auditor for the Government-wide financial statements and, in our view, is the de facto group auditor for Government-wide financial statement audits. We recognize GAO's authority under the group auditing standards and will continue to make every effort to supp01i their audit of the Government-wide financial statements. As oversight paiiners, we will continue to encourage GAO to take an active role in the DoD financial statement audits. We welcome timely feedback and input when GAO's preferences on the nature, timing and extent of audit procedures differ from what the OIG or IPA auditors intend to execute.

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Throughout the FY 2012 and FY 2013 audits, GAO auditors who were providing oversight did not always provide timely input. We are encouraged by the progress that was made in the FY 2014 audit and look forward to this being the foundation for all future DoD

financial statement audits where GAO provides oversight. Because we want GAO to rely on our audit work, we value GAO's advice and experience. As a result, we expanded the level of testing in both the FY 2013 and 2014 audits and will remain mindful of their preferences and interpretations of audit standards in our future work.

During the FY 2014 audit, the level of communication between the audit teams of GAO, the OIG, and the IPA have improved with GAO participating in extensive meetings to discuss the IPA's audit approach. Agreements were reached that addressed GAO's preferences and interpretations of standards. Since the entrance conference for the FY 2014 USMC SBA audit, DoD OIG audit management and the IPA firm have been engaged in frequent discussions with GAO and repeatedly requested feedback on whether GAO agreed that the audit approach was in accordance with auditing standards and GAO's preferences.

Completeness of Transactions

The GAO report states that OIG did not perform sufficient procedures to determine the completeness of transactions reported on the Marine Corps' Fiscal Year 2012 General Fund Schedule

DoD OIG Response: We do not agree with the repo1i findings that our audit lacked sufficient procedures to assess the completeness of transactions to determine the reliability of certain evidence, and whether budgetary activity was recorded in the proper period. We believe the FY 2012 audit properly considered and evaluated the audit evidence. Each of these audit areas requires a significant level of professional judgment. During the audit, more than 5,600 transactions were evaluated by the DoD OIG and Independent Public Accounting (IPA) firm auditors to determine whether they were properly recorded on the USMC SBA. In addition, numerous other tests, including tests of the significant IT systems we1e also performed. While we acknowledge that some of the audit decisions could have been documented better, the FY 2012 USMC SBA audit met professional standards. However, because GAO had previously expressed preferences about some aspects of the testing conducted during the FY 2012 audit, we expanded the level of testing and documentation in the FY 2013 audit and fmiher expanded this effort again during the FY 2014 audit to address GAO's preferred approach. This additional analysis showed that the USMC recorded outlays in an average of 17 days. This average time was shorter than our 30-day cut-off testing period, and supports that our 30 day cut-off testing period was sufficient.

We acknowledge that the GAO report describes some possible ways to test the completeness of the FY 2012 Schedule. However, audit standards do not prescribe that these are the only acceptable approaches and allow other alternative approaches, including those that we used to assess the completeness of transactions included on the FY 2012 schedule. Because of challenges obtaining documentation to suppo1i older transactions, the Depa1iment limited the

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FY 2012 SBA to just current year transactions. Accordingly, we limited our testing to only FY 2012 appropriations because these transactions were the primary focus of the audit eff01i.

During the audit, we performed various risk assessments for each account, performed testing of detailed transactions for completeness, and performed multiple reconciliations.

Specifically, we performed reconciliations of military payroll disbursements recorded in the Monthly Payroll Reconciliation/Certification Voucher (MRCV) to the USMC general ledger system, (referred to as the Standard Accounting, Budgeting, and Repo1iing System SABRS); civilian payroll disbursements recorded in the Defense Civilian Payroll System (DCPS) to SABRS; and reserve payroll disbursements recorded in MRCV to SABRS. In addition, we tested abnormal balances to determine if there were unrecorded obligations. We also performed testing of the SABRS unmatched files and traced the totals to the SBA to provide additional assurance the USMC's disbursements were fairly presented. We validated that the SABRS data file agreed to the SABRS trial balance; and that the SABRS trial balance agreed to the Defense Depaiimental Reporting Systems (DDRS) unadjusted trial balance (UTB) and that the DDRS UTB tied to the SBA to provide assurance over the completeness of the SBA. Finally, we performed year-end cut-off testing to provide assurance that transactions were recorded in the appropriate period. In our professional judgment, based on the totality of these auditing procedures, we reduced the risk of material misstatement related to completeness of outlays and obligations to an acceptable level.

Figure 3 on page 14 of the GAO draft repmi is incomplete. The figure indicates that rejected transactions are removed from SABRS with no process to eventually include the corrected transactions into SABRS. In addition, the GAO's natTative indicates that USMC personnel were not actively analyzing and c01Tecting the rejected transactions. Both Figure 3 and the related narrative could mislead readers of this report. Although there was not a formal policy in place in FY 2012, USMC was actively reviewing, analyzing, and cotTecting rejected transactions. We documented our understanding of the USMC process in the audit workpapers that GAO reviewed.

The GAO report expressed concern that we did not complete a full comparison of

FY 2012 SABRS transaction activity to the FY 2012 Fund Balance with Treasury reconciliation to assist in providing assurance over completeness of budgetary transactions. Although this is an acceptable testing procedure to gain assurance over completeness, it is not a required audit procedure. We obtained an understanding of the cross-disbursement process and the reconciliation performed by USMC for this process. Further, we traced selected transactions to the reconciliation and documented our understanding. Although we believe the FY 2012 audit work was sufficient, we understand the preferences GAO had regarding completeness testing.

To further reduce audit risk, we performed additional Fund Balance with Treasury control procedures during our FY 2013 and FY 2014 USMC SBA audits to address GAO's concerns and noted no material misstatements from these additional audit procedures.

The completeness concern discussed in the March 23, 2015, DoD OIG memo withdrawing the FY 2012 USMC SBA unqualified opinion report was not related to system interface concerns raised by GAO. The OIG withdrew its FY 2012 USMC SBA opinion, in accordance with AU Section 561, because subsequently discovered facts regarding suspense

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accounts identified during the FY 2014 audit caused us to question the completeness of the information on which we based our FY 2012 opinion. While we were aware that USMC transactions were contained in Navy and other DoD suspense accounts during the FY 2012 USMC SBA audit, the available information during the audit indicated that the scope of transactions did not pose a risk of material misstatement or a need to test the transactions in suspense accounts as a separate population. However, the FY 2014 auditors obtained new information during the audit that demonstrated a higher risk associated with DoD transactions contained in Treasury suspense accounts. Through discussions with USMC and DFAS persom1el about the nature and quantity of transaction's posted in these suspense accounts, the auditors determined enough uncertainty existed to question the completeness of the FY 2012 Schedule. Because this problem has DoD-wide implications, we announced a comprehensive audit on May 1, 2015, "Audit of the DoD Suspense Accounts" (Project No.

D2015-DOOOFE-0186.000). This audit will specifically address the challenges that the Army, Navy, Air Force and Defense Agency suspense accounts pose to the ongoing audits of the SBA as well as future audits of the full financial statements.

As explained above, because of the challenge in obtaining documentation to support older transactions, the Department limited the FY 2012 SBA to only CUITent year transactions. Accordingly, we limited our testing to only FY 2012 appropriations. The GAO repo1i contends that a risk of material misstatement exists related to transactions recorded in FY 2012 to prior year appropriations that USMC should have charged to FY 2012 appropriations. Specifically, the report states that over $3.8 billion in FY 2012 outlay activity was recorded to prior fiscal year appropriations. This information overstates the risk to the FY 2012 SBA because the outlay activity in FY 2012 would include charges to one-year appropriations, as well as multi-year appropriations. In addition, due to the types of products and services USMC purchases, outlays on one-year appropriations can be made up to 5 years after the initial obligation. Therefore, it is expected that USMC would have significant outlays to prior year appropriations during FY 2012.

However, the FY 2012 SBA audit appropriately excluded these transactions because the schedule only included current year appropriations. In addition, the FY 2012 audit addressed the risk that GAO mentions. Specifically, during first quarter testing for both FY 2012 and

FY 2013, we did not identify any material transactions that were recorded in the wrong fiscal year or posted to the wrong appropriation. As a result of FY 2011, FY 2012, and FY 2013 testing we determined the risk of recording transactions in the incorrect period was low.

The report also concluded that there was a risk of a material amount of feeder system data not included in the USMC general ledger even though the extensive work GAO perf01med did not identify any material transactions that were omitted from the SBA. During our audit, we tested over 5,600 transactions and concluded that the FY 2012 UMSC SBA was materially correct. This conclusion was supported by over 12,000 documents, emails, position papers and auditor workpapers that were provided to GAO. Although we believe the work completed in FY 2012 was sufficient, we understand the concerns the GAO has presented and their preferred audit approach. As a result, we performed additional procedures during our FY 2013 audit and the IPA also performed additional testing during the FY 2014 USMC SBA audit to address GAO's preferences and interpretations of the audit standards, including expanded cut-off testing and additional system interface testing to ensure transactions were properly posted to the USMC

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accounting system. Both of these expanded audit efforts did not identify any material transactions in feeder systems that were inappropriately omitted from the USMC general ledger.

Summary of OIG actions to address GAO's concerns:

1. To address GAO concerns about the length of the cut-off perio9 that we selected, during the FY 2013 and 2014 audits we performed further analysis on the amount of time that USMC normally needed to record disbursement transactions.
2. To address concerns about the reliability of certain evidence, we increased our review of sample transactions that the contracted-IPA initially reviewed. In FY 2013, we used tatistical methods in determining the number of sample transactions to review. This increased level of effort verified that sufficient and reliable evidence was provided by USMC and assessed by the IPA. For the FY 2014 audit, the IPA further modified the audit procedures to include testing of error reports resulting from USMC's processing of transactions from feeder systems. This testing specifically addressed GAO's concern about the completeness of significant USMC feeder data.
3. Additional deliverables are being incorporated into future contracts to address concerns raised by the GAO regarding the completeness of IT feeder systems.

Reliability of Evidence

The GAO report states that OIG did not perform sufficient procedures to determine the reliability of certain evidence used to support transactions in the Marine Corps Schedule

DoD OIG Response: We believe that audit evidence used to test the USMC schedule was appropriate and permissible under audit standards. We considered the USMC as a standalone reporting entity and not a DoD component. Using this approach, we developed audit procedures that considered USMC's business partners to be vendor-type relationships. We anticipated addressing any DoD problems not directly attributable to, or unique to, the USMC during other DoD component level audits. However, the GAO report implies that all cross-cutting problems within DoD should be fully remediated by every component level audit (or before any component-level audits are started).

Audit standards and the FAM permit both internal and external evidence to be used to support the auditors' conclusions, but the auditor must use professional judgment in evaluating the quality of the evidence. Both Auditing Standard No. 15 (which superseded AU Section 326 for audits of fiscal years beginning on or after December 15, 2010) and GAO/PCIE FAM section 470 discuss the types of evidence and generalizations about the quality of the types of evidence available. For instance, evidence obtained from a knowledgeable source that is independent (external evidence) is generally more reliable than evidence obtained only from internal company sources (internal evidence).

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Based on the audit approach, we do not consider information obtained from the Defense Logistics Agency (DLA) and U.S. Transportation Command to be internal evidence. Rather, based on the guidance in Auditing Standard No. 15, GAO/PCIE FAM section 470, and conclusions reached after reviewing AT Section 801, "Reporting on Controls at a Service Organization" and AU-C 402, "Audit Considerations Relating to an Entity Using a Service Organization," we considered DLA and U.S. Transportation Command to be business vendor of USMC. This conclusion was appropriate since USMC maintained control over authorizing the transactions flowing through these activities and also was responsible for the accountability of these transactions. Further, USMC management lacked the ability to influence or exercise direct control over decisions and budgets of these separate agencies. Therefore, information obtained from agencies and Commands independent from USMC would be considered corroborating external evidence. An example of appropriate evidence to review from a third party vendor, as suggested in FAM 470 is "invoices for expenses and the purchase of inventory and property." During the audit, we did not receive any information that raised significant doubts about the third party information that would preclude its use as sufficient and appropriate audit evidence to supp01i the FY 2012 USMC SBA.

The GAO rep01i expresses concern about the reliability of feeder system data. The report contends that we should have performed additional procedures on the external evidence obtained because there was other information that should have raised doubt about its reliability.

Specifically, the GAO report notes that DoD rep01ied DLA MILSTRIP as a department-wide material weakness in its FY 2012 Agency Financial Repo1i. Although we agree that there are weaknesses surrounding MILSTRIP processes, the FY 2012 Agency Financial Report does not conclude that the data within the system is unreliable. Additionally, the reported weaknesses would not prevent the auditors from using the MILSTRIP inf01mation to complete the audit tests. Specifically, we used the information from DLA MILSTRIP to corroborate internal information received from USMC. For example, we used the Logistics Data Gateway (LDG) report from the MILSTRIP process to verify the total cost and date an order was placed (obligation), received, and paid (outlay). We also reviewed the LDG rep01i for the type of item ordered, the quantity ordered, received, and paid, unit price, mathematical accuracy, and for returns that were not recorded in SABRS.

To address the concerns that GAO raised about the reliability of certain evidence used, we increased our review of sample transactions that the contracted-IPA initially reviewed.

During the FY 2013 audit, we used statistical methods in determining the number of sample transactions to review. This increased level of effort verified that sufficient and reliable evidence was provided by USMC and assessed by the IPA. For the FY 2014 audit, the IPA further modified the audit procedures to include testing of error reports resulting from USMC's processing of transactions from feeder systems. This testing specifically addressed GAO's concern about the completeness of significant USMC feeder data. In addition, during the FY 2014 audit, the IPA performed additional audit procedures to obtain a more thorough understanding of the DLA MILSTRIP business process. These additional procedures did not result in any significant concerns or change the auditors prior conclusions about the reliability of the evidence used to supp01i USMC transactions processed through MILSTRIP.

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It is important to note that audit standards do not require an SSAE No. 16 examination of systems information so that the results can be used to corroborate data from another entity.

Because USMC was not relying solely on DEAMS to send information directly to DDRS for financial statement reporting on behalf of USMC, consistent with audit standards, we did not require an SSAE No. 16 examination or conduct additional testing of the information that was outside the scope of the audit. Additionally, the DoD OIG repo1i on DEAMS was not relevant to the information obtained from DEAMS because the report did not specifically address data quality. Rather, this report addressed DEAMS managers not maintaining an adequate Chart of Accounts (COA) and DEAMS not reporting financial data directly to DDRS. Although there were financial rep01iing concerns identified, the audit did not determine that the information in DEAMS was unreliable. Therefore, the DEAMS audit results did not prevent us from relying on the information contained in DEAMS. Our use of the information obtained from DEAMS to c01rnborate information obtained from USMC was both appropriate and allowable under the audit standards.

Although we issued a disclaimer of opinion on DoD's department-wide financial statement for FY 2012, that audit effort did not include any tests of the DEAMS or MILSTRIP data that was used to corroborate the USMC transactions. Under Section 1008 of the 2002 National Defense Authorization Act, the DoD IG is required to limit its audit procedures unless DoD management asse1is that it is ready for audit. Because the Department had not asserted that its DoD-wide financial statements were auditable, this audit repo1i was based on minimal audit procedures to support the disclaimer. As a result, there was no direct connection between the results of the DoD-wide financial statement audit rep01i and the audit of the USMC SBA for FY 2012.

The FY 2012 USMC SBA was compiled using transactions contained in the USMC accounting system and general ledger. We considered this information to be the initial evidence received to support the SBA. During testing of specific sample transactions, the evidence obtained from the third parties was used to confirm that USMC accurately recorded the transactions in the accounting system. Therefore, in accordance with Auditing Standard No. 15 and GAO/PCIE FAM sections 420 and 470, we appropriately considered all types of audit evidence and the reliability of that evidence when evaluating and concluding on audit procedures performed.

Summary of OIG additional actions to address GAO concerns:

1. To address the concerns raised about the reliability of ce1iain evidence used, we increased our review of sample transactions that the contracted-IPA initially reviewed. In FY 2013, we used statistical methods in determining the number of sample transactions to review.
2. With respect to external evidence from USMC business partners, during the FY 2014 audit, the IPA performed additional audit procedures to obtain a more thorough understanding of the DLA MILSTRIP business process.

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3. To further consider the risks discussed by the GAO repo1i, OIG is planning future audits of MILSTRIP and USTRANSCOM info1mation to determine whether it is sufficiently reliable evidence for use in financial statement audits.
4. For the FY 2015 audit, additional deliverables are being incorporated into the IPA contract to address concerns raised by the GAO regarding the reliability of IT feeder system data.

Cut-off testing

The GAO report states that OIG did not perform sufficient procedures to determine whether budget activity was recorded in the proper period and whether shipment obligations were properly recorded

DoD OIG Response: Auditing standards do not prescribe a specific amount of time that is appropriate for cut-off testing. We believe that the FY 2012 USMC audit appropriately considered the analyses of the business processes and results of testing that was performed. However, we acknowledge that the audit documentation could have more clearly explained our judgment in establishing a cut-off testing period of 30 days. As documented in our audit workpapers, we considered audit results from FY 2011, FY 2012 and FY 2013 (first quarter) as a basis for our cut-off testing period and procedures. Although the FY 2011 statistical testing of obligations identified 6 transactions that USMC should have recorded in FY 2010, the Marine Corps recorded a year end adjustment to account for this error. During first quarter testing for both FY 2012 and FY 2013, we did not identify any material transactions that were recorded in the wrong fiscal year or posted to the wrong appropriation. As a result of FY 2011, FY 2012, and FY 2013 testing, we determined the risk of recording transactions in the incorrect period was low. After considering all these audit procedures, we determined cutoff testing for one month after year-end would be sufficient.

Because of the preferences that GAO presented, we performed additional analysis in FY 2013 to determine the average time an outlay took to post to the general ledger. On average, outlays reviewed by the DoD OIG took approximately 17 days from the day it was paid until it was recorded in the general ledger. In addition, the auditors significantly extended the FY 2014 cut-off testing until February 2015. Consistent with the FY 2012 and 2013 cut-off testing results, no material amount of transactions were inappropriately recorded in the wrong fiscal year or posted to the wrong appropriation.

While we agree with GAO that some transactions may be recorded in the wrong period, neither the additional analyses performed during the FY 2013 and FY 2014 audits nor the factors that the GAO report presented support the conclusion that there was a high risk of a material amount of transactions recorded in the wrong fiscal year. Although there were some DoD-wide transactions that were recorded in the improper period, USMC did not rep01i any instances and we did not identify any material instances where USMC recorded transactions in an improper period. While the GAO repo1i correctly states that obligations for transportation charges have

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been a challenge for the Army, Navy, and Air Force, USMC developed an estimate to counter the risks that GAO presented. Additionally, the draft report is misleading when stating, "the DoD OIG was aware the Marine Corps was performing analysis of approximately $21 million of shipment billing in January 2013--4 months after the end of the fiscal year-to determine the extent of adjustments needed to record the related outlay transactions to fiscal year 2012 and prior year appropriations." GAO auditors were present during a series of meetings to assess this situation and they were made aware that, out of the $21 million mentioned in the GAO report, only approximately $1 million was adjusted to record the outlay in a prior fiscal year appropriation. During the FY 2012 audit, we performed several audit procedures on the adjustments the GAO mentioned. After these analyses, we determined any amount that may have been adjusted would be immaterial to the schedule taken as a whole.

It is important to note the context of the statement OIG auditors made about cut-off errors that could be identified during the FY 2013 audit that would require a restatement for the

FY 2012 SBA. The draft report omits a critical fact that FY 2012 cut-off testing was ongoing at the same time as the FY 2013 audit. Thus, the test results of the FY 2013 audit could be used to inform the ongoing FY 2012 audit. Since similar testing for first quarter FY 2013 had already been completed for the FY 2013 audit, there would be no reason to perform duplicative testing.

The OIG audit staff was trying to communicate to GAO that if material misstatements were noted in the FY 2013 testing, we would consider those results in the conclusions for the FY 2012 opinion. As noted in the FY 2013 testing, we did not have significant errors related to cut-off, including the transactions recorded against FY 2013 appropriations.

We believe the cut-off testing performed on outlays was both sufficient and in accordance with audit standards. For outlay cut-off testing, the initial testing results noted seven exceptions. In further testing, the auditors were able to trace four of the exceptions to the SABRS unmatched file, which was then traced to the SBA to ensure those transactions were included in the final outlays presented. Therefore, it was appropriate to conclude that those four transactions were not exceptions. We obtained additional details for the three remaining exceptions and were able to determine that they were correctly excluded from the SBA since the outlay did not occur until the next fiscal year. The 14 other transactions were supported by evidence obtained from DLA, an agency external to the USMC, to corroborate the information provided by USMC.

We also believe that sufficient audit procedures were performed to determine whether the accounting estimate for transportation shipment was reasonable in the context of the schedule taken as a whole. While the GAO repo1i presented two options available under AU Section 342, there are a total of nine procedures that auditors may consider when assessing the reasonableness of an accounting estimate and there is no requirement in the standards to perform all nine procedures. As part of our assessment of the shipping obligation estimate, we performed four of the nine procedures outlined in the audit standards. Specifically, we (1) identified sources of data and determined whether such data and factors were relevant, reliable, and sufficient for estimation; (2) evaluated whether the assumptions were consistent with supporting data and relevant historical data; (3) reviewed available documentation of the assumptions made by management; and (4) tested the calculations used by management to translate the assumptions and key factors into the estimated shipping obligations. Based on our understanding of the

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estimate, we determined historic liquidations were the relevant data used in calculating the accounting estimate. We performed various analyses of the historic liquidations to assess the reliability of outlay transaction data used for determining obligation liquidation rates, including:

- Analytics to determine the reliability of the historic liquidations for FY 2008, FY 2009, FY 2010, FY 2011, and FY 2012;
- Use of detailed transaction data from prior audit coverage, the detailed transaction data from FY 2012, and the detailed transaction data from the FY 2013 audit coverage to recreate the liquidation populations;
- Verifying that the summarized liquidations presented on the USMC estimate agreed with the USMC detailed liquidation data files; and
- Testing for liquidations in FY 2010, FY 2011, and FY 2012 to detem1ine if USMC recorded the correct liquidation amount per the detailed vouchers.

In reviewing the estimate and gaining an understanding of the factors and assumptions management made when developing the estimate of the shipping obligations, we considered the impact of different types of shipment outlay rates. USMC developed a risk assessment applying this concept. The process was documented in the Universe and Adjustment Methodology written and provided by USMC.

Overall, we considered and documented the risk related to some of the reliability and completeness testing and decided to perform multiple additional tests to determine the overall reasonableness of the estimate of the shipment obligations. As a result of the audit procedures performed, we determined that obligations as recorded were overstated by approximately $53.7 million and recommended that USMC make an adjustment. USMC agreed with the analysis and made the adjustment. Based on the totality of the audit procedures we performed, we concluded that there was sufficient and appropriate evidence that the accounting estimate of the shipment obligations reported on FY 2012 USMC SBA was reasonable.

Summary of OIG additional actions to address GAO concerns:

1. To address GAO concerns about the length of the cut-off period that we selected, during the FY 2013 audit we performed further analysis on the amount of time that USMC normally needed to record disbursement transactions .
2. During the FY 2014 USMC audit, the IPA significantly expanded cut-off testing into March 2015.
3. With respect to shipment obligations, in both the FY 2013 and 2014 audits, we assessed USMC's shipping obligation estimate using four of the nine options in AU section 342

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Materiality and Conclusions

The GAO report states that OIG did not properly consider and evaluate the audit evidence in concluding and reporting on the results of the audit.

DoD OIG Response: We believe that the results of the audit work were properly considered and that we appropriately evaluated the audit evidence in accordance with all applicable audit standards to conclude and report on the FY 2012 USMC SBA results. As noted above, we will consider the results of our ongoing suspense account audits, this repo1i from GAO and other ongoing IG reports prior to deciding if or when to reissue the opinion. During the FY 2012 audit, all known misstatements or known risk factors were appropriately considered. We performed both a quantitative and qualitative assessment when concluding and reporting the results of the audit. In doing the final quantitative risk assessment, we calculated the materiality exposure for each line item of the SBA and included the audit precision which resulted in misstatements related to errors and untested amount of approximately $773 million. Although we disagree with the GAO conclusion that we did not include all known misstatements, if we did include the additional misstatements GAO reported, the revised misstatements related to errors and untested amounts would be approximately $808.8 million which is still below the overall materiality threshold of $826 million. While the report states that "further misstatement may exist," no examples of material or immaterial misstatements were provided as examples to support this asse1iion. Therefore, because the schedule was materially correct, and the total materiality threshold was not exceeded, an unqualified opinion was appropriate.

The GAO draft rep01i states that we made an assumption that the unsupported outlay transactions could be an adjustment and repo1ied as advance payments to avoid counting the amounts as untested. While we agree with GAO that USMC may not always properly record ce1iain progress payment transactions, we specifically obtained evidence that an outlay occurred related to a valid obligation. Therefore, for purposes of the SBA, the balance of gross outlays on the face of the Schedule would be unaffected by these compliance issues. The compliance issue was reported to USMC in FY 2010 and has continued to be reviewed and updated as necessary. In addition, the Report on Internal Control and Compliance with Laws and Regulations associated with the FY 2012 USMC SBA audit opinion appropriately discusses the lack of sufficient internal controls to ensure the proper recording of contract-progress-payment transactions.

In addition to the quantitative calculations, we also reviewed several qualitative factors including: the relationship between the USSGL accounts and its impact of misstatements in individual accounts versus the impact on the overall SBA; Congressional and public interest; and open findings and recommendations and the impact on the reliability of the information presented in the SBA. Although we concluded the qualitative factors did not affect the overall presentation of the SBA, we did include information in the rep01i to discuss those factors that may affect the USMC as they move to full financial statement audits. For example, we added an explanatory paragraph to the audit opinion to ale1i the reader that some transactions were not correctly recorded in the underlying general ledger accounts. We explained the misstatements did not have an effect on the fair presentation of the Schedule, but future audits of the full

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Statement of Budgetary Resources or the other financial statements, such as the Balance Sheet, could be adversely affected by these enors.

We agree with GAO that technical support from the DoD OIG Quantitative Methods Division (QMD) is key in providing auditors assistance in determining the appropriate population so that audit results are defensible. However, we disagree with the report statement that QMD expressed no opinion regarding the projection of the results. Although, QMD expressed some concern with the statistical methods used by the IPA auditors, it is important to note that QMD confirmed that the statistical projections were calculated accurately and signed the certification. The draft report omits this key point.

While we agree with the GAO draft report that we could have more clearly documented the auditor judgments made in determining the audit opinion;

we believe the audit documentation shows a clear timeline of the decision making process and the workpapers documenting the testing demonstrated those decisions. For example, as of September 6, 2013 we initially concluded based on the results of cutoff testing that we were unable to gain assurance of the completeness of populations for the Obligations Incurred and Outlays line items on the SBA. However, additional audit procedures and follow-up effo1i cleared the exceptions or resulted in a proposed adjustment to the SBA Obligations Incurred line item. The GAO draft report does not reflect this additional work that was performed.

Based on the totality of the work performed, we believe that alternative auditing procedures successfully addressed concerns related to the completeness of populations used for testing historical shipment liquidation transactions that were not addressed as part of the audit. Although we did not have access to historical unadjusted trial balances for FY 2008 and FY 2009, we performed additional testing of historic liquidations to make info1med conclusions. We also performed substantive analytical procedures to determine the reliability of the historic liquidations for FY 2008, FY 2009, FY 2010, FY 2011, and FY 2012; and we verified that the summarized liquidations presented on the USMC estimate agreed with the USMC detailed liquidation data files to gain sufficient assurance over the historic liquidations.

Summary of OIG additional actions to address GAO concerns

For all future opinions issued by the DoD OIG, we are developing a comprehensive decision paper template that will fully document criteria and audit results that suppo1i the conclusions and OIG decisions for determining the appropriate audit opinion to issue.

Resolving Differences of Opinion

We agree with GAO that audit organizations should establish policies and procedures for addressing and resolving differences of opinion within the engagement team. Throughout the audit, the most experienced auditors who were Certified Public Accountants were involved in key decisions. Any formal escalation process to resolve disagreements amongst the team and management would have involved these same senior leaders. However, based on the recommendation of this repo1i, we are developing a formalized process for elevating

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disagreements between audit teams and management. We are currently drafting revisions for our audit handbook that will specifically address how differences of opinion amongst team members and between team members and senior leaders will be resolved. Prior to finalizing these revisions, we will share this with GAO and incorporate any observations they may have.

In conclusion, we appreciate the opp01iunity to review and comment on the draft GAO report. As indicated above, in our professional judgment, the FY 2012 audit of the USMC SBA was performed in accordance with applicable audit standards. As noted previously, we will consider the results of our ongoing suspense account audits, this report from GAO, and other ongoing IG reports prior to deciding if or when to reissue the opinion. In addition, because of the concerns that GAO raised during their review of the FY 2012 audit, additional audit procedures were performed during the FY 2013 and 2014 audits. Implementing the proposed recommendations in this report will help ensure that GAO will be able to rely on future audits as part of their audit of the Government-wide consolidated financial statement audit.

Daniel R. Blair,

CPA Deputy Inspector General for Auditing

Accessible Text for Appendix III: Comments from the United States Marine Corps

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DEPARTMENT OF THE NAVY

HEADQUARTERS UNITED STATES MARINE CORPS 3000 MARINE CORPS PENTAGON

WASHINGTON,DC 20350-3000

In Reply Refer to:

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20 May 15

From: Fiscal Director of the Marine Corps

To: Government Accountability Office (GAO)

Subj: MANAGEMENT COMMENTS TO THE GAO DRAFT REPORT GA0-15-198, ACTIONS ARE NEEDED ON AUDIT ISSUES RELATED TO THE MARINE CORPS'2012 SCHEDULE OF BUDGETARY ACTIVITY

1. Unless otherwise noted, these management comments only address the Marine Corps specific issues included in the report section titled "The Marine Corps Has Not Taken Timely Actions to Address Identified Accounting, Reporting, and System-related Internal Control Weaknesses." Overall, we concur with this section of the GAO report regarding Marine Corps actions needed on audit issues related to the United States Marine Corps' Schedule of Budgetary Activity (SBA) for Fiscal Year {FY) 2012, but we provide the following management comments .
2. Cutoff Testing of Outlay Transactions {Page 28). The report inaccurately states that "...the OIG subsequently requested that the Marine Corps provide documentation for a sample of 334 outlay transactions for substantive testing of end-of-period cut-off. However, the Marine Corps responded that it was unable to provide support ..." In fact, the Marine Corps successfully supported two separate cutoff tests of 105 samples each. Although DoDIG personnel may have deliberated requiring an additional cutoff sample of 334 transactions, the Marine Corps was not issued additional cutoff samples to support. Under no circumstance did we decline to support any sample sets that were issued to us.
3. Timely Actions to Address Identified Accounting Reporting, and System-related Weaknesses and Limited Progress in Addressing Internal Control Weaknesses Identified by the OIG (Page 35-41). While the report credits the Marine Corps for improving remediation efforts and strengthening its monitoring process, the Marine Corps does not concur with the assertion that "significant uncorrected control weaknesses continue to impair the Marine Corps' ability to produce consistent, reliable and sustainable financial information for day-to-day decision making on its missions and operations. "While we agree with the importance of internal controls, they are but one factor that

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contributes to the financial information used for decision making. Even before the Marine Corps began its audit journey, we have been committed to strengthening internal controls and enhancing our business process. The Marine Corps has also focused on modernizing our financial management systems and improving our financial reporting process.Further, the Marine Corps has either initiated or proactively served in many workgroups to improve business processes, identify and mitigate internal control weaknesses, and increase the accuracy, reliability, and timeliness of financial management information.

4. Concerning the progress of addressing internal control weaknesses, GAO report focuses on a baseline of 177 total recommendations issued from the FY 2010 and FY 2011 audits, which resulted in disclaimers of opinion due to inability to complete the audits within available timeframes, and the FY 2012 audit - the first time that all designated audit work was completed. Throughout that time, along with the subsequent completion of the FY 2013 and FY 2014 audit work, we have gained heightened understanding of the interrelationships between some findings and recommendations and recognition that effective corrective actions may differ somewhat from the original recommendations . Consequently, based on the original 82 financial reporting recommendations outlined in Table 2 on page 37 of the report - along with the 11 recommendations closed by DoDIG - we have successfully remediated an additional 17 recommendations and await validation testing from DoDIG or an independent audit firm. Additionally, due to reinforced coordination with our IT stakeholders and testing through the completion of the FY 2014 SBA audit, we successfully remediated 94 of the 95 IT system recommendations .
5. The Marine Corps acknowledges that much work remains to fully mitigate internal control weaknesses. As our audit activity matured and we recognized the need to provide focused attention and leadership on corrective actions, we formally established the Remediation Section within the Risk and Compliance Branch in February 2014. Although the majority of corrective actions must be implemented by the process owners throughout the Marine Corps, the branch is working to establish

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appropriate staffing levels to ensure effective orchestration and oversight of all corrective actions, plus the successful development and execution of Internal Controls over Financial Reporting(ICOFR) and Internal Controls over Financial Systems (ICOFS) test plans .

6. Since the January 2014 date in the GAO report, the Marine Corps has increased its resources to execute a more robust controls-based test plan of the Marine Corps-owned systems based on the Federal Information System Control Audit Manual (FISCAM) methodology with a particular emphasis on business process , application level, and interface control objectives. We have also engaged external system owners undergoing or completing Statement on Standards for Attestation Engagements (SSAE) so the Marine Corps can review the test results, ascertain additional control objectives/techniques, and develop test plans for Complementary User Entity Controls (CUEC).
7. Lastly, we concur with the issue noted in the GAO report related to challenges in hiring personnel with the requisite education and experience in financial statement audits or business process or internal control reviews. This is a specialized skill set that is not typically resident in current military or government civilian workforce.Therefore, we continue to explore avenues to hire personnel with these skills and may require special hiring authorities to achieve success.
8. We look forward to working with GAO and other interested parties in future audit and remediation efforts.

Signature of A.M. McDermott

A.M. MCDERMOTT

Copy to: ASN (FM&C)

Accessible Text for Appendix IV: Comments from the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer

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OFFICE OF THE UNDER SECRETARY OF DEFENSE

1100 DEFENSE PENTAGON WASHINGTON. DC 20301-1100

May 21, 2015

Mr. Asif A. Khan

Director, Financial Management and Assurance

U.S. Government Accountability Office 441 G Street, NW, Mailstop 5Q24 Washington, DC 20548

Dear Mr. Khan:

Thank you for the opportunity to comment on draft report GA0-15-198, "Actions Are Needed on Audit Issues Related to the Marine Corps' 2012 Schedule of Budgetary Activity." The DoD Office of Inspector General (as auditor and most recently in its oversight role of the independent public accounting firm conducting this audit) and the U.S. Marine Corps (USMC) have been directly involved with this audit. Appropriately, their comments focus on the details of this report. In contrast, the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer and its Financial Improvement and Audit Readiness (FIAR) team have been monitoring this audit for several years. Therefore, my comments will focus on the broader implications the report has on DoD audit readiness.

We agree that accurate reconciliations of transaction universes are critical for accountability, and must include the ability to regularly "tie out" financial feeder systems to the general ledger. Further, an entity under audit must assume ownership of its complete end-to-end business processes carrying financial information and be able to rely on data provided by other service providers acting on behalf of other entities. As highlighted in the May 2015 FIAR Plan Status Report and discussed during monthly updates with you and your team, we have specific ongoing actions to continue identifying and remediating reconciliation deficiencies. For example, we have 19 control audits (Statement on Standards for Attestation Engagements 16) in place or planned to support all impacted DoD organizations, to include the USMC. The DoD business environment is arguably the largest and most complex business environment in the world and much of its complexity results from the many organizations involved in our business processes . While these dependencies provide efficiencies and produce required operational outcomes, their impact on financial auditability is becoming clearer as a result of our audit expenence.

The lessons from the USMC audit are an outstanding example of why the audit experience is so important to the Department. Understanding and applying lessons learned from audits directly contributes to the significant auditability progress we are making on this massive change management effort. However, while your report highlights areas for improvement, it does not recognize many of the corrections and improvements already made by the USMC, nor does it constructively mention the value of the audit to the Marine Corps or other organizations who will be applying its lessons. I appreciate that you have always informally acknowledged progress in our regular updates. We look forward to your continued engagement and closer examination of how we have implemented these changes.

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I am absolutely convinced of the value of moving DoD organizations to a regular audit regimen as a way to reinforce an improved level of business discipline. The Department is committed to improving the quality of its financial information and achieving auditability. We also commend the U.S. Marine Corps and the Department of the Navy for their leadership in setting the pace for bringing the Department under an audit regimen.

Mark E. Easton

Duty Chief Financial Officer

Accessible Data for Charts

Accessible Data for Figure 1: Marine Corps Fiscal Year 2012 General Fund Appropriations Received

Appropriations Category	Percentage	Dollars (in billions)
Military Personnel	52.3%	$15.00
Operations and Maintenance	34.1%	$9.80
Procurement	9.1%	$2.60
Appropriations shared with the Navy	4.5%	$1.30

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