



INSPECTOR GENERAL

U.S. Department of Defense

DECEMBER 4, 2015



Quality Control Review of the BKD, LLP FY 2014 Single Audit of MRIGlobal and Related Entities

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

December 4, 2015

Partner
BKD, LLP

Board of Directors
MRIGlobal

Regulatory Compliance Accounting Analyst
MRIGlobal

SUBJECT: Quality Control Review of the BKD, LLP FY 2014 Single Audit of MRIGlobal and Related Entities (Report No. DODIG-2016-029)

We are providing this report for your information and use. We considered management comments on a draft of this report when preparing the final report. The management comments were responsive; therefore, additional comments are not required.

As the cognizant Federal agency for MRIGlobal and Related Entities (MRIGlobal), we performed a review of the BKD, LLP single audit report and supporting audit documentation for the year ended September 30, 2014. The purpose of our review was to determine whether the single audit was conducted in accordance with auditing standards and the requirements of the Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." We conducted this review in accordance with the Council of Inspectors General on Integrity and Efficiency (CIGIE) "Quality Standards for Inspection and Evaluation."

BKD, LLP generally met auditing standards and OMB Circular A-133 requirements, and no additional work is required for the FY 2014 single audit. However, we identified performance and documentation deficiencies that need to be addressed in future single audits. BKD, LLP agreed to take corrective action in response to our recommendations.

We appreciate the courtesies extended to the staff. For additional information on this report, please contact Ms. Carolyn R. Hantz at (703) 604-8877 (DSN 664-8877).

A handwritten signature in black ink, appearing to read "R. Stone", is positioned above the name of the Deputy Inspector General.

Randolph R. Stone
Deputy Inspector General
Policy and Oversight

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Introduction

Objective

As the cognizant Federal agency¹ for MRIGlobal and Related Entities (MRIGlobal), we performed a quality control review of the BKD, LLP (BKD) single audit report and supporting audit documentation for the audit period of October 1, 2013 through September 30, 2014. Our objective was to determine whether the single audit was conducted in accordance with generally accepted government auditing standards, generally accepted auditing standards (GAAS), and the requirements of the Office of Management and Budget (OMB) Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations.” Appendix A contains additional details on our scope and methodology. Appendix B lists the compliance requirements that BKD determined to be applicable to the FY 2014 audit.

Background

MRIGlobal and Related Entities

MRIGlobal is a not-for-profit research and development organization based in Kansas City, Missouri. MRIGlobal performs scientific research, advanced engineering, and program integration and management related to national security and defense, energy and environment, and other areas for clients in government, industry, and academia. During FY 2014, MRIGlobal expended approximately \$66.7 million in Federal awards under one Federal program, the research and development cluster, \$48.6 million of which was expended for Department of Defense awards. MRIGlobal engaged BKD to perform the FY 2014 single audit.

BKD, LLP

BKD is a national accounting and advisory firm headquartered in Springfield, Missouri, that provides audit and assurance, tax, and advisory services to United States and international clients. BKD maintains its own system of internal quality control over its accounting and auditing practices as required by the American Institute of Certified Public Accountants (AICPA). BKD’s Kansas City, Missouri office performed the MRIGlobal FY 2014 single audit.

¹ OMB Circular A-133 states that the cognizant agency is the Federal agency that provides the predominant amount of direct funding to a non-Federal entity and is the Federal agency designated to perform quality control reviews.

Single Audit

Public Law 98-502, “The Single Audit Act of 1984,” (the Act) as amended, was enacted to promote sound financial management of Federal awards administered by non-Federal entities and to establish a uniform set of auditing and reporting requirements for Federal award recipients that are required to obtain a single audit. OMB Circular A-133 establishes policies that guide the implementation of the Act and provides an administrative foundation for uniform audit requirements of non-Federal entities administering Federal awards. Entities that expend Federal funds of \$500,000 or more in a year are subject to the Act and OMB Circular A-133 requirements. Therefore, MRIGlobal must have an annual single audit performed and submit a complete reporting package to the Federal Audit Clearinghouse in accordance with OMB Circular A-133 requirements. The single audit includes an audit of the non-Federal entity’s financial statements and Federal awards as described in OMB Circular A-133.

Review Results

MRIGlobal complied with OMB Circular A-133 reporting requirements. BKD generally met auditing standards and OMB Circular A-133 requirements, and no additional audit work is required for the FY 2014 single audit. However, we identified deficiencies in performance and documentation that need to be addressed for future single audits.

Management Comments and DoDIG Response

BKD, LLP agreed to take corrective action in response to our recommendations. Management comments were responsive and no additional comments are needed. Management comments are included in their entirety at the end of this report.

Finding A

Internal Control Testing

BKD's methodology for identifying the number of items to test internal control over compliance with requirements for the Federal program did not always meet the sampling guidance in the AICPA's, "Audit Guide on Government Auditing Standards and Circular A-133 Audits" (Audit Guide). For testing internal controls over the activities allowed or unallowed and allowable costs/cost principles (collectively "allowable cost") compliance requirements, BKD auditors did not ensure that sample sizes were consistent with the Audit Guide. For testing internal controls over the equipment management compliance requirement, BKD used a methodology that the Audit Guide states is not appropriate for testing internal control over compliance. We obtained additional explanations and determined that there was sufficient evidence to support conclusions on internal controls. For future single audits, BKD should ensure that sample sizes comply with the Audit Guide.

Sample Size for Tests of Controls

The sample size BKD auditors selected for testing internal control over compliance with Federal programs did not always meet guidance in the Audit Guide. For tests of controls over the allowable cost compliance requirements, BKD auditors used their policy for financial statement audits which resulted in a sample size that was less than the recommended minimum sample sizes. For tests of controls over the equipment management requirement, BKD performed procedures on a limited number of individually important items, which is a methodology that is not appropriate for testing internal control over compliance. Insufficient sample sizes could result in auditors not obtaining sufficient audit evidence to support conclusions on internal control and properly plan the audit procedures for testing compliance with requirements.

The Audit Guide² is applicable to single audits and provides recommendations on the application of GAAS that auditors are required to consider in planning and performing the audit. Auditors that do not apply the auditing guidance should document how the requirements of GAAS were complied with in the circumstances addressed by such auditing guidance.

² The AICPA Audit Guide is an interpretative publication issued under the authority of the Auditing Standards Board. The members of the Auditing Standards Board have found this auditing guidance to be consistent with existing generally accepted auditing standards.

Allowable Cost Compliance Requirements

BKD selected sample sizes for the allowable cost compliance requirements that were generally consistent with recommendations in the Audit Guide. However, BKD incorrectly defined the population for testing controls over timesheets; therefore, the resulting sample size was smaller than the minimum recommended. BKD auditors used their policies on financial statement audits and defined population sizes based on the frequency of the control being tested. For example, items subject to a weekly control were defined to have a population size of 52 weeks.

Auditors are required to obtain a high level of assurance that internal controls are operating as designed. To achieve this, the Audit Guide recommends that, for tests of controls, populations of more than 250 items, should have a minimum of 25 items selected, and for populations between 52 and 250 items, a minimum of 10 percent of the population should be selected.

BKD auditors tested four key controls to determine the operating effectiveness of internal control over the allowable cost requirements. They selected adequate samples for three of the key control tests, but did not select an adequate sample to test the control of timesheet approvals. The population for testing the timesheet approval control should have been the total number of timesheets. MRIGlobal had approximately 450 personnel working on Federal programs in FY 2014, therefore, the timesheet population was greater than 250 and BKD should have selected a minimum sample of 25 items to be in compliance with the Audit Guide recommendations. However, because timesheets were approved weekly, BKD defined a population size of 52 and only selected 10 timesheets for review. Although this was in accordance with BKD's policy for testing internal controls in financial statement audits, it resulted in an inadequate sample size to test the effectiveness of internal control over compliance.

We accepted that BKD obtained sufficient evidence to support their conclusion that the risk of noncompliance with the allowable cost requirements was low because they tested adequate sample sizes for three of the four key controls tested. For future audits, BKD should ensure that sample sizes are consistent with the sample sizes recommended in the Audit Guide.

Equipment Management Compliance Requirement

BKD used a "key item" methodology to test the effectiveness of internal controls over the equipment management compliance requirement; however, the Audit Guide states this methodology is not appropriate for testing internal controls. The key item methodology involved testing a sufficient number of individually important items to appropriately reduce the risk of material noncompliance. Using this

methodology, BKD selected the highest value item to perform internal control testing, but did not select and perform testing on the remaining items in the population because they determined that the remaining items' aggregate value did not represent a high risk of material noncompliance.

The Audit Guide discusses testing individually important items as a useful tool for testing compliance with requirements, but states that this methodology relates to compliance testing, not to testing of internal control over compliance. The audit documentation indicated MRIGlobal purchased 238 equipment items in FY 2014; therefore, a minimum sample size of approximately 24 items should have been selected in accordance with the Audit Guide's suggested 10 percent of items for small populations. As discussed in Finding B, the key control BKD identified for testing internal control over compliance did not meet the audit objectives for the equipment management requirement. However, based on additional information on internal control testing provided by BKD, we do not believe the use of the key item methodology impacted the FY 2014 audit's overall conclusions on the equipment management compliance requirement. For future audits, BKD should ensure that the testing methodology used is appropriate for testing internal control over compliance.

Recommendations, Managements Comments, and Our Response

Recommendation A

We recommend the Partner, BKD, LLP:

- 1. Select internal control testing sample sizes in future single audits that comply with the guidance in the AICPA "Audit Guide on Government Auditing Standards and Circular A-133 Audits."**
- 2. Provide the Department of Defense Office of Inspector General with the audit documentation from the FY 2015 single audit that demonstrates corrective action taken to address the deficiencies for the activities allowed or unallowed, allowable costs/cost principles, and the equipment management compliance requirements.**

BKD, LLP Comments

The Partner, BKD, LLP agreed to take the recommended actions.

Our Response

BKD, LLP comments are responsive to our recommendations. No additional comments are needed.

Finding B

Performance and Documentation of the Federal Program Audit

BKD needs to improve the documentation of procedures performed to support the Federal program audit conclusions. Specifically, the audit documentation did not provide details of all equipment purchased with Federal funds or BKD's consideration of all equipment when assessing materiality and planning audit procedures for the equipment management requirement. In addition, audit documentation for the equipment management and reporting compliance requirements did not always provide a clear description of audit procedures performed or the evidence obtained to support the conclusions. We required additional explanations and supporting documentation in order to determine whether there was sufficient evidence to support conclusions on these two requirements.

Equipment Acquired with Federal Funds

BKD auditors did not document their consideration of the value of all equipment acquired with Federal funds when assessing materiality and performing audit procedures to determine MRIGlobal's internal control over and compliance with equipment management requirements. BKD's audit documentation indicated that the materiality determination was based on the cumulative cost of equipment purchased and disposed of under Federal awards during FY 2014; however, equipment requirements apply to all equipment acquired with Federal funds regardless of the year purchased. Although BKD auditors correctly determined that the equipment management compliance requirement was direct and material, they should have included documentation that showed they considered all equipment purchased with Federal funds when planning and performing audit procedures.

Auditors are required to consider the OMB Circular A-133, "Compliance Supplement," (Compliance Supplement) in determining which compliance requirements have a direct and material effect on Federal programs. For the research and development cluster, Part 5 of the Compliance Supplement informs auditors that assessing only the equipment purchased with Federal funds during the year under review may not properly address requirements for the continued use of equipment on Federally sponsored programs or the non-Federal entity's safeguarding of equipment maintained over multiple years. Additionally, Part 3

of the Compliance Supplement includes one suggested audit procedure to select a sample from all equipment acquired under Federal awards to physically inspect the equipment and determine whether it is being appropriately safeguarded and maintained. However, a physical inspection of equipment performed in a subsequent fiscal year cannot ensure that equipment was adequately safeguarded and maintained in the past. Therefore, a current physical inspection would not provide additional evidence for conclusions on the equipment management requirement for the FY 2014 single audit. We believe that it is in the Government's best interest for BKD to take corrective action for future single audits.

Audit Documentation

BKD obtained an understanding of internal controls, but did not adequately document the audit procedures performed to test internal controls over and compliance with equipment management and reporting requirements. Auditing standards³ require that audit documentation be appropriately detailed to provide a clear understanding of the work performed, the evidence obtained, and the conclusions reached. Documentation and audit evidence should be in sufficient detail to enable an experienced auditor, with no previous connection to the audit, to understand the nature, timing, extent, and results of audit procedures that support significant judgments and conclusions.

For the equipment management compliance requirement, BKD identified the approval of equipment purchases as a key control; however, it was not clear how that key control would meet the audit objective. The audit objective for the equipment requirement includes determining whether the non-Federal entity maintains proper records and whether equipment is adequately safeguarded and maintained. We discussed this with the audit partner, who stated that after further analysis, a better key control would have been that MRIGlobal separately tracks fixed assets purchased with Federal funds and also conducts an equipment inventory by project at least every 2 years. For compliance testing, BKD's audit program indicated that the auditors observed whether equipment was appropriately safeguarded and maintained and also verified that MRIGlobal had performed a physical inventory. The audit program provided references to documentation where the tests were performed, but the referenced documentation provided no additional supporting details. Although BKD did not adequately document the audit procedures performed to meet the equipment management requirement, we obtained additional information through inquiries to BKD and have accepted that there is sufficient evidence to support audit conclusions.

³ Auditing standards include both generally accepted government auditing standards and GAAS.

For the reporting compliance requirement, BKD's audit documentation did not clearly describe the procedures performed. For example, one working paper documented that a sample of three reports was selected for testing internal controls, while another working paper stated that a sample of ten percent of the population was selected. In another instance, BKD's documentation of the audit procedures performed was not clear because the procedures identified in the audit program were not adequately cross-referenced to the compliance testing working paper. BKD provided additional explanations that were sufficient to support its conclusions on the reporting compliance requirement.

Recommendations, Managements Comments, and Our Response

Recommendation B

We recommend the Partner, BKD, LLP:

- 1. Consider all equipment acquired with Federal funds to assess whether the equipment management compliance requirement is direct and material and to design appropriate audit procedures to sufficiently test internal control over and compliance with this requirement in future single audits.**
- 2. Improve audit documentation for future single audits to address deficiencies identified in this report so that documentation includes sufficient details to describe the audit procedures performed and evidence obtained to support conclusions on tests of internal controls over and compliance with the equipment management and reporting compliance requirements.**
- 3. Provide the Department of Defense Office of Inspector General with the audit documentation from the FY 2015 single audit that demonstrates corrective action taken to address the deficiencies identified in this report.**

BKD, LLP Comments

The Partner, BKD, LLP agreed to take the recommended actions.

Our Response

BKD, LLP comments are responsive to our recommendations. No additional comments are needed.

Appendix A

Scope and Methodology

We reviewed the BKD FY 2014 single audit of MRIGlobal submitted to the Federal Audit Clearinghouse on January 22, 2015. We used the 2015 edition of the Council of Inspectors General on Integrity and Efficiency (CIGIE) “Guide for Quality Control Reviews of OMB Circular A-133 Audits.” CIGIE approved this guide for performing quality control reviews of single audits. We conducted our review from March 2015 through October 2015 in accordance with the “Quality Standards for Inspection and Evaluation.” The review focused on the following qualitative aspects of the single audit:

- qualification of auditors,
- auditor independence,
- due professional care,
- planning and supervision,
- audit follow-up,
- internal control and compliance testing for the research and development cluster,
- schedule of expenditures of Federal awards, and
- data collection form.

Use of Computer-Processed Data

We did not use computer-processed data to perform this audit.

Prior Coverage

During the last 5 years, we have not issued any quality control reviews related to BKD or MRIGlobal.

Appendix B

Compliance Requirements

Table. BKD Determination of the Applicability of Compliance Requirements for the Research and Development Cluster

OMB Circular A-133 Compliance Requirements	Applicable	Not Applicable/ Not Material
Activities Allowed/Unallowed	X	
Allowable Cost/Cost Principles	X	
Cash Management	X	
Davis-Bacon Act		X
Eligibility		X
Equipment and Real Property Management	X	
Matching, Level of Effort, Earmarking		X
Period of Availability of Federal Funds		X
Procurement, Suspension, and Debarment	X	
Program Income		X
Real Property Acquisition and Relocation Assistance		X
Reporting	X	
Subrecipient Monitoring	X	
Special Tests and Provisions		X

Management Comments

BKD, LLP



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November 6, 2015

Mr. Randolph R. Stone
 Deputy Inspector General for Policy and Oversight
 Office of Inspector General
 Department of Defense
 4800 Mark Center Drive
 Alexandria, Virginia 22350-1500

Subject: Project No. D2015-DAPOSA-0143.000

Dear Mr. Stone:

BKD, LLP is providing the below responses to the findings in the draft report dated October 22, 2015 titled "Quality Control Review of **BKD, LLP** FY 2014 Single Audit of MRIGlobal and Related Entities."

Finding A: Internal Control Testing

Finding: BKD's methodology for identifying the number of items to test internal control over compliance with requirements for the Federal program did not always meet the sampling guidance in the AICPA's, "Audit Guide on Government Auditing Standards and Circular A-133 Audits" (Audit Guide). For testing internal controls over the activities allowed or unallowed and allowable costs/cost principles (collectively "allowable cost") compliance requirements, BKD auditors did not ensure that sample sizes were consistent with the Audit Guide. For testing internal controls over the equipment management compliance requirement, BKD used a methodology that the Audit Guide states is not appropriate for testing internal control over compliance. We obtained additional explanations and determined that there was sufficient evidence to support conclusions on internal controls. For future single audits, BKD should ensure that sample sizes comply with the Audit Guide.

Response: We agree that the sample sizes selected for testing internal control over compliance for two tests (one for allowable costs testing and one for equipment management) did not conform to the sampling guidance provided by Circular A-133. In both situations, we feel that other testing resulted in sufficient audit evidence to support our assessed level of control risk. We will ensure that the appropriate sample sizes for internal control over compliance testing will be selected in future single audits and will provide the Department of Defense Office of Inspector General with documentation from our FY 2015 single audit to demonstrate corrective action was taken to address the above deficiency.

Finding B: Performance and Documentation of the Federal Audit Program

Finding: BKD needs to improve the documentation of procedures performed to support the Federal program audit conclusions. Specifically, the audit documentation did not provide details of all equipment purchased with Federal funds or BKD's consideration of all equipment when assessing materiality and planning audit procedures for the equipment management requirement. In addition, audit documentation for the equipment management and reporting compliance requirements did not always provide a clear



BKD, LLP (cont'd)

description of audit procedures performed or the evidence obtained to support the conclusions. We required additional explanations and supporting documentation in order to determine whether there was sufficient evidence to support conclusions on these two requirements.

Response: Although our documentation for determining whether the equipment management compliance requirement was direct and material did not specifically note that all equipment acquired with Federal funds was considered in our assessment, our consideration did consider this and resulted in a correct determination. Our testing of physically inspecting equipment purchased with Federal funds could have been improved to better document our consideration of equipment purchased in prior years. We agree that our audit documentation could be enhanced to better describe the audit procedures performed and evidence obtained to support our conclusions for compliance with the equipment management and reporting requirements. We have reemphasized the audit documentation requirements and the need to have clear and concise documentation with the engagement team. We ensure that such documentation will be improved for future single audits and will provide the Department of Defense Office of Inspector General with documentation from our FY 2015 single audit to demonstrate corrective action was taken to address the above deficiency.

Sincerely,



Tondée L. Lutterman
Partner

TLL:MW:kh

Acronyms and Abbreviations

AICPA	American Institute of Certified Public Accountants
BKD	BKD, LLP
CIGIE	Council of Inspectors General on Integrity and Efficiency
GAAS	Generally Accepted Auditing Standards
MRIGlobal	MRIGlobal and Related Entities
OMB	Office of Management and Budget



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For more information about DoD IG reports or activities, please contact us:

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