



INSPECTOR GENERAL

U.S. Department of Defense

SEPTEMBER 29, 2016



Quality Control Review of the Dixon Hughes Goodman LLP FY 2014 Single Audit of Logistics Management Institute

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Results in Brief

Quality Control Review of the Dixon Hughes Goodman LLP FY 2014 Single Audit of Logistics Management Institute

September 29, 2016

Objective

We conducted a quality control review of the Dixon Hughes Goodman LLP (DHG) FY 2014 single audit of Logistics Management Institute (LMI) to determine whether the single audit was conducted in accordance with auditing standards and the requirements of the Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

Findings

The DHG single audit contained quality deficiencies that affect the reliability of the audit results and require corrective action before Federal agencies can rely on the overall opinion on LMI's compliance with requirements for the research and development cluster. The DHG auditors:

- did not perform internal control and compliance testing sufficient to meet the audit objective for the procurement, suspension, and debarment compliance requirement;
- did not review LMI's internal control over the cash management and reporting compliance requirements, as required; and
- did not perform adequate audit procedures to support the conclusion that the subrecipient monitoring compliance requirement was not direct and material to the audit.

Findings (cont'd)

The DHG auditors should also improve compliance testing for the allowable costs/cost principles compliance requirement to ensure the review of indirect costs is adequately performed and documented.

Recommendations

We recommend that the Partner, DHG:

- perform additional audit procedures to determine the adequacy of LMI's internal control over and compliance with the procurement, suspension, and debarment compliance requirement and of LMI's internal control over cash management and reporting compliance requirements.
- perform additional audit procedures to determine whether the subrecipient monitoring compliance requirement is direct and material to the Federal program.
- improve the documentation of audit procedures in future audits to verify whether LMI properly charged indirect costs to Federal awards.

Management Comments and Our Response

Comments from the Partner, DHG, addressed all specifics of the recommendations, and no further comments are required. Please see the Recommendations Table on the back of this page.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Dixon Hughes Goodman LLP	None	A.1, A.2, A.3, A.4, B.1, B.2, C.1, and C.2



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
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September 29, 2016

Board of Trustees
Logistics Management Institute

Controller
Logistics Management Institute

Partner
Dixon Hughes Goodman LLP

SUBJECT: Quality Control Review of the Dixon Hughes Goodman LLP FY 2014 Single Audit of Logistics Management Institute (Report No. DODIG-2016-138)

We are providing this report for your information and use. The Dixon Hughes Goodman LLP (DHG) single audit of Logistics Management Institute for the fiscal year ended September 30, 2014, contained quality deficiencies that affect the reliability of the audit results and require corrective action. We conducted this review in accordance with the "Quality Standards for Inspection and Evaluation," published in January 2012 by the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

We considered management comments on a draft of this report when preparing the final report. Comments from the Partner, DHG, addressed all specifics of the recommendations; therefore, no further comments are required.

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", with a long horizontal line extending to the right.

Randolph R. Stone
Deputy Inspector General
Policy and Oversight

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Introduction

Objective

As the cognizant Federal agency¹ for Logistics Management Institute (LMI), we performed a quality control review of the Dixon Hughes Goodman LLP (DHG) 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, 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 DHG determined to be applicable to the FY 2014 single audit.

Background

Logistics Management Institute

Logistics Management Institute is a not-for-profit organization specializing in addressing Government management issues. LMI offers strategic consulting services in logistics, acquisition and financial management, infrastructure management, information management, organizational improvement, and policy and program support. During FY 2014, LMI expended \$107 million in Federal awards, including \$74 million under one Federal program, the research and development cluster.² Of the \$107 million, \$59 million was expended for Department of Defense awards. LMI engaged DHG to perform the FY 2014 single audit.

Dixon Hughes Goodman LLP

Dixon Hughes Goodman LLP is an accounting firm headquartered in Charlotte, North Carolina, and providing assurance, tax, and advisory services to United States and international clients. DHG employs more than 2,000 people in 12 states. DHG maintains its own system of internal quality control over its accounting and auditing practices as required by the American Institute of Certified Public Accountants. DHG’s office in Tysons, Virginia, performed the LMI FY 2014 single audit.

¹ Office of Management and Budget 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.

² The research and development cluster is made up of a variety of research and development activities performed under different types of funding agreements, such as grants, cooperative agreements, and contracts that have common compliance requirements.

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 all 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, the entities must have an annual single or program-specific audit performed in accordance with generally accepted government auditing standards and submit a complete reporting package to the Federal Audit Clearinghouse. 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

The Dixon Hughes Goodman LLP audit contained quality deficiencies that affect the reliability of the audit results and require corrective action for the LMI FY 2014 single audit. Specifically, the auditors did not adequately perform audit procedures for their review of the procurement, suspension, and debarment; cash management; reporting; and subrecipient monitoring compliance requirements (Findings A and B). As a result, DHG needs to complete additional audit work to support its audit conclusions before Federal agencies can rely on the overall opinion on LMI's compliance with requirements for the research and development cluster. In addition, we identified a deficiency in the review of indirect costs for the allowable costs/cost principles compliance requirement that needs to be addressed in future audits (Finding C). LMI complied with OMB Circular A-133 reporting requirements.

Finding A

Audit Procedures Performed for the Procurement, Suspension, and Debarment; Cash Management; and Reporting Compliance Requirements

DHG auditors did not adequately perform audit procedures for their review of LMI's internal control over and compliance with procurement, suspension, and debarment requirements and of LMI's internal control over cash management and reporting requirements. The audit procedures were not adequate because the DHG auditors did not perform internal control and compliance testing that met the audit objective for the procurement, suspension, and debarment requirement. DHG auditors also did not review LMI's internal control over the cash management and reporting requirements, as required by OMB Circular A-133. As a result of these deficiencies, the audit documentation did not provide sufficient appropriate evidence to support audit conclusions on the procurement, suspension, and debarment; cash management; and reporting compliance requirements.

Internal Control and Compliance Testing for Procurement, Suspension, and Debarment

DHG auditors documented their understanding of internal control, but did not perform adequate internal control and compliance testing for the procurement, suspension, and debarment requirement that met the audit objective identified in the OMB Circular A-133 Compliance Supplement. The 2014 OMB Circular A-133 Compliance Supplement states that the audit objective for this requirement is to determine whether LMI made procurements in compliance with Federal regulations, including verifying entities were not suspended or debarred before entering into a covered transaction.

DHG auditors documented that LMI had procedures in place that complied with applicable Federal requirements and that LMI's policies included retaining the basis for contractor selection, price analysis, and justification for lack of competition. DHG auditors also documented that the procedures included verifying that an entity was not suspended or debarred before making a purchase. However, DHG auditors did not perform adequate internal control and compliance testing to verify that LMI adhered to its procedures. Although ensuring policies are in place that meet applicable Federal requirements is important, additional audit procedures are necessary to test LMI's internal control over and compliance with requirements. As a result, we concluded the audit documentation did not provide sufficient evidence to support the audit conclusions on the procurement, suspension, and debarment compliance requirement.

Internal Control Testing

DHG auditors documented internal control testing to support multiple compliance requirements, including activities allowed or unallowed; allowable costs/cost principles; period of availability of Federal funds; and procurement, suspension, and debarment. The control test performed was to verify LMI's approval of the vendor invoice by the appropriate party. The approval being tested occurs before payment when an item or service is received, but it is unclear how this internal control would provide assurance that LMI complied with Federal regulations, including the basis for contractor selection, price analysis, and justification of lack of competition, when making a purchase.

We asked the DHG audit partner how the approval of the vendor invoice related to the procurement process or if any additional controls were tested. The DHG audit manager stated that the vendor invoice approval indicated approval of the procurement procedures. She also stated that the auditor inquired of the LMI Controller and corroborated with the Director of Contracts that written documentation of the procurement process and procurement approval is maintained.

Auditing standards require the auditors to design and perform audit procedures that are appropriate for the purpose of obtaining sufficient appropriate audit evidence to support their conclusions. Further, inquiry of management alone ordinarily does not provide sufficient appropriate audit evidence and is not sufficient to test the operating effectiveness of controls. The DHG auditors did not identify the approval of the vendor invoice as a control in the understanding of internal control for the procurement, suspension, and debarment requirement. Also, it is not apparent how this approval would provide assurance that LMI complied with Federal regulations when making a purchase. As a result, we concluded that the audit documentation did not contain sufficient evidence to support conclusions that internal controls were operating effectively for the procurement, suspension, and debarment compliance requirement.

Compliance Testing

DHG auditors verified that entities under covered transactions were not suspended or debarred for the transactions reviewed. However, there was no compliance testing documented to verify that LMI complied with the procurement requirements when making the purchase. When asked, DHG indicated that the compliance testing was performed through its inquiry of management as documented in the understanding of internal control. We agree that the auditor inquired of LMI management and reviewed policies and procedures. However, DHG did not perform audit procedures to verify that LMI followed its procedures when

making purchases. In fact, the DHG audit program identified audit steps related to procurement compliance testing, but those steps were crossed out as if they were not applicable to the audit.

We also noted the DHG auditors determined that a sample size of 40 items was the minimum required for compliance testing, but the auditors tested only 35 items when determining whether entities were not suspended or debarred. The DHG auditors performed compliance testing on the same sample selected for the activities allowed or unallowed and allowable costs/cost principles compliance requirements. The total sample size was 100 items but because 65 sample items were payroll expenditures, they were not applicable to procurement, suspension, and debarment requirements. Therefore, DHG did not perform compliance testing as planned to support conclusions on suspension and debarment because DHG auditors only tested 35 items rather than the planned 40 items.

Overall, the DHG auditors did not perform compliance testing for procurement requirements and did not test a sufficient number of items for suspension and debarment requirements. As a result, the DHG audit documentation did not provide sufficient evidence to support DHG's conclusions on LMI's compliance with procurement, suspension, and debarment requirements.

Internal Control Testing for Cash Management and Reporting

The DHG auditors obtained and documented an understanding of LMI's internal control over cash management and reporting compliance requirements, but did not perform adequate audit procedures to verify that internal controls for these two requirements were operating effectively. OMB Circular A-133 requires auditors to perform testing of internal control over compliance requirements. Specifically, it requires the auditor to obtain an understanding of internal control over Federal programs, plan the testing of internal control to support a low assessed level of control risk for major programs, and perform the testing of internal control as planned. When internal control over some or all compliance requirements are likely to be ineffective in preventing or detecting noncompliance, the auditor does not need to test internal control but is required to report a significant deficiency or material weakness. The DHG auditors did not report a significant deficiency or material weakness in internal control over compliance. In addition, the audit documentation did not provide sufficient evidence to support that internal controls were operating effectively and to plan the compliance testing for the cash management and reporting requirements.

Cash Management

The DHG auditors did not perform adequate audit procedures for their review of internal control over compliance with cash management requirements. The DHG auditors determined that LMI receives its awards mainly through cost-reimbursement contracts. The 2014 OMB Circular A-133 Compliance Supplement states that when organizations are funded on a reimbursement basis, the audit objective for the cash management requirement is to verify that program costs are paid by the organization before reimbursement is requested from the Federal Government. The Federal Acquisition Regulation states that when a non-Federal entity is not delinquent in paying costs in the ordinary course of business, reimbursement may be requested for costs incurred but not necessarily paid. The ordinary course of business generally means within 30 days of the request to the Federal Government for reimbursement.

DHG auditors documented that a key control over cash management requirements was the review and approval of the Government submitted invoice. However, DHG auditors did not test this key control. The documented internal control testing focused on controls over cash receipts, not the controls LMI had in place to ensure compliance with cash management requirements. The DHG auditors tested whether:

- cash receipts information is valid and processed only once,
- cash receipts information is recorded in the correct amount and to the correct receivable account, and
- cash received is posted in the proper period, and all cash receipts are recorded.

The documented testing was not relevant to the audit objective of the cash management compliance requirement because it did not provide any evidence that LMI's internal controls were effective to ensure compliance with Federal regulations when requesting reimbursement from the Government. As a result, we concluded that the DHG auditors did not perform adequate testing of internal control over cash management requirements.

Reporting

The DHG auditors did not perform audit procedures to verify LMI's internal control over compliance with reporting requirements. The 2014 OMB Circular A-133 Compliance Supplement states that the audit objective for the reporting compliance requirement is to determine whether the required reports for Federal awards include all activity of the reporting period, are supported by applicable accounting records, and are fairly presented in accordance with governing requirements. The audit documentation was not clear on the audit procedures performed to test internal control and compliance with the reporting requirement because the description within the testing spreadsheet did not include sufficient details.

Auditing standards 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.

We followed up with the DHG audit manager to obtain additional explanation and information on the procedures performed for internal control and compliance testing. The DHG audit manager referenced the audit program that identifies the steps performed to review compliance. We accepted that the audit procedures performed for compliance testing met the objectives for the requirement. However, the audit documentation did not indicate that any testing was performed to verify LMI's internal controls were effective to ensure compliance with reporting requirements. As a result, we concluded that the DHG auditors did not perform testing of internal control as required by OMB Circular A-133.

Recommendations, Management Comments, and Our Response

Recommendation A

We recommend that the Partner, Dixon Hughes Goodman LLP:

- 1. Perform additional audit procedures for the FY 2014 single audit, at no additional cost to the Government, to determine the adequacy of Logistics Management Institute's internal control over and compliance with the procurement, suspension, and debarment compliance requirement.**

Dixon Hughes Goodman LLP Comments

The Partner, DHG, stated that the DHG auditors tested LMI's key controls over the procurement, suspension, and debarment compliance requirement, but acknowledged that their documentation could be improved to reflect the detailed testing performed. He agreed to take the recommended actions by reperforming procedures over internal control and performing additional procedures over compliance with the procurement, suspension, and debarment compliance requirement.

Our Response

Comments from the Partner addressed all specifics of the recommendation, and no further comments are required.

2. **Perform additional audit procedures for the FY 2014 single audit, at no additional cost to the Government, to determine the adequacy of Logistics Management Institute's internal control over cash management and reporting compliance requirements and plan and perform further compliance testing as necessary.**

Dixon Hughes Goodman LLP Comments

The Partner, DHG, stated the audit team determined that the reporting compliance requirement did not have a direct and material effect on the research and development cluster. He stated that DHG auditors would improve their documentation to provide support for that determination. The Partner acknowledged that audit documentation could be improved to reflect the testing performed on internal control over cash management. He agreed to take the recommended actions and reperform procedures over internal control over cash management.

Our Response

The DHG audit documentation indicates that the reporting compliance requirement is direct and material to the research and development cluster; and therefore, audit procedures are required to be performed over the compliance requirement. However, if the DHG auditors can document sufficient evidence that the reporting compliance requirement is not direct and material, then we would consider that action as having satisfied the intent of the recommendation. Comments from the Partner addressed all specifics of the recommendation, and no further comments are required.

3. **Revise the Office of Management and Budget Circular A-133 report, as required by auditing standards, to reflect the additional audit work performed and coordinate with Logistics Management Institute to file the reporting package with the Federal Audit Clearinghouse.**

Dixon Hughes Goodman LLP Comments

The Partner, DHG, agreed to take the recommended action and revise the OMB Circular A-133 report to reflect the additional work performed.

Our Response

Comments from the Partner addressed all specifics of the recommendation, and no further comments are required.

4. **Provide the Department of Defense Office of Inspector General with the audit documentation on the FY 2014 audit that demonstrates corrective actions taken to address the reported deficiencies for the procurement, suspension, and debarment; cash management; and reporting compliance requirements.**

Dixon Hughes Goodman LLP Comments

The Partner, DHG, agreed to take the recommended action and provide the DoD Office of Inspector General with the corresponding audit documentation.

Our Response

Comments from the Partner addressed all specifics of the recommendation, and no further comments are required.

Finding B

Subrecipient Monitoring Compliance Requirement

DHG auditors did not perform adequate audit procedures to determine whether the subrecipient monitoring compliance requirement was direct and material to the research and development cluster. Specifically, the DHG auditors did not verify that the subrecipient costs provided by LMI were accurate or that subrecipient costs were not direct and material. As a result, the audit documentation did not provide sufficient appropriate evidence to support the auditors' conclusion on the subrecipient monitoring compliance requirement.

Direct and Material Determination

DHG auditors concluded that the subrecipient monitoring compliance requirement was not direct and material to the research and development cluster. As a result, they did not perform any audit procedures to review LMI's internal control over and compliance with the compliance requirement. However, our review disclosed inconsistencies in the audit documentation related to the materiality determination on the subrecipient monitoring compliance requirement. Therefore, we concluded that there was not sufficient evidence to support conclusions on whether this compliance requirement should have been included in the scope of the audit.

DHG auditors documented the FY 2014 subcontract costs totaled \$217,261 and concluded that because it was less than the DHG established performance materiality of \$3.7 million, the subrecipient monitoring requirement was not direct and material to the research and development cluster. LMI identified \$50,354 in subrecipient awards in the notes to the schedule of expenditures of Federal awards (SEFA). We asked the DHG auditors about the source of the subcontract costs identified in the audit documentation and whether it included the subrecipient awards identified by LMI. We were initially told that the \$50,354 identified by LMI was part of the \$217,261 amount identified in the audit documentation, but subsequently we were told the \$217,261 amount represented subcontractor administrative burden rather than actual subcontract costs.

During our review of the audit documentation, we noted that LMI's trial balance included two accounts identified as subcontract costs with amounts of \$18.7 million and \$16.4 million. LMI provided details on these accounts that showed expenditures from multiple non-Federal entities being charged to Federal awards. LMI informed us that the \$50,354 subrecipient amount identified in the SEFA notes was included in the two accounts.

When deciding whether the subrecipient monitoring compliance requirement applies, the auditor must first assess whether the non-Federal entity entered into any relationships under the Federal award that should be considered subawards. A subrecipient relationship exists when funding from a pass-through entity³ is provided to perform a portion of the scope of work of the pass-through entity's award agreement with the Federal awarding agency. A subaward may be provided through any form of legal agreement, including an award that a pass-through entity makes under a Federal cost-reimbursement contract that is subject to the Federal Acquisition Regulation and referred to as a "subcontract." Pass-through entities may also make subawards to for-profit entities. Because for-profit subrecipients are not subject to the audit requirements of OMB Circular A-133, pass-through entities are responsible for establishing requirements, as needed, to ensure for-profit subrecipient accountability for the use of funds. DHG auditors should have performed audit procedures to verify the accuracy of the amount LMI identified as subrecipient awards and to determine whether other costs should have been identified and included in the materiality determination for the subrecipient monitoring compliance requirement.

We asked the DHG audit partner whether its auditors performed audit procedures to verify the basis LMI used to identify subrecipients. The DHG audit manager replied no, explaining that DHG auditors obtained an understanding of the subrecipient and subcontractor expense process and discussed and corroborated the process with the LMI Controller and Assistant Controller in charge of contracts. She also noted that the LMI staff members responsible for administering Federal contracts and approving expenditures charged to contracts have sufficient knowledge to identify subrecipient expenses.

Auditing standards require the auditors to obtain sufficient appropriate audit evidence by performing and documenting audit procedures to support their conclusions. The discussion with LMI was not included in the audit documentation and although discussion may be a valid method to obtain information, auditing standards state that inquiry of management alone ordinarily does not provide sufficient appropriate audit evidence. DHG auditors did not document procedures to verify that the \$50,354 subrecipient amount included in the SEFA notes was accurate. In addition, DHG auditors did not perform procedures to verify whether any of the subcontract costs included in the trial balance accounts should have been identified as subawards subject to subrecipient monitoring requirements. As a result, we concluded that the audit documentation did not provide sufficient evidence to support conclusions that the subrecipient monitoring compliance requirement was not direct and material to the audit.

³ A pass-through entity means a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.

Recommendations, Management Comments, and Our Response

Recommendation B

We recommend that the Partner, Dixon Hughes Goodman LLP:

1. **Perform additional audit procedures for the FY 2014 single audit, at no additional cost to the Government, to determine whether the subrecipient monitoring compliance requirement is direct and material to the Federal program, plan and perform internal control and compliance testing as necessary, and revise the Office of Management and Budget Circular A-133 report to reflect the additional audit work performed.**

Dixon Hughes Goodman LLP Comments

The Partner, DHG, agreed to take the recommended actions and will review LMI's process to identify subrecipients, identify subcontract costs, document a determination of whether subrecipient monitoring is a direct and material compliance requirement, and if necessary, test LMI's internal control over and compliance with the subrecipient monitoring compliance requirement. The Partner agreed to revise the OMB Circular A-133 report to reflect the additional work performed.

Our Response

Comments from the Partner addressed all specifics of the recommendation, and no further comments are required.

2. **Provide the Department of Defense Office of Inspector General with the audit documentation for the FY 2014 audit that demonstrates corrective actions taken to address the reported deficiencies for the subrecipient monitoring compliance requirement.**

Dixon Hughes Goodman LLP Comments

The Partner, DHG, agreed to take the recommended action and provide the DoD Office of Inspector General with the corresponding audit documentation.

Our Response

Comments from the Partner addressed all specifics of the recommendation, and no further comments are required.

Finding C

Allowable Costs Compliance Testing

DHG auditors did not adequately document compliance testing for the allowable costs/cost principles (allowable costs) compliance requirement. Although DHG auditors performed adequate audit procedures for the review of direct costs, they did not adequately perform and document that indirect costs were properly charged to Federal awards. As a result, the DHG auditors were required to provide additional explanation and documentation for us to conclude there was sufficient evidence to support audit conclusions on the allowable costs compliance requirement.

Indirect Costs Testing

The DHG auditors adequately performed and documented audit procedures to verify that direct costs were being properly charged to Federal awards. However, they did not adequately perform and document audit procedures to verify indirect costs were properly charged to Federal awards.

The 2014 OMB Circular A-133 Compliance Supplement, Parts 3 and 5, provide guidance for the review of the allowable costs compliance requirement. The guidance includes audit objectives related to both direct and indirect costs and identifies indirect costs as the second major category of cost charged to research and development projects. The overall audit objective for indirect costs is to determine whether the non-Federal entity charged indirect costs to Federal awards in compliance with Federal regulations and negotiated rate agreements, as applicable.

The DHG audit program identified procedures for the review of direct costs but did not identify procedures for the review of indirect costs. We also noted the sample items that DHG selected and tested for allowability were all direct costs charged to Federal awards. We requested additional explanation from the auditors as to why indirect costs were not tested. The DHG audit manager explained that the population pool from which the sample was drawn included all costs charged to the contracts being tested. She further stated that DHG selected the sample from the entire population of costs charged to Federal awards because DHG did not deem it necessary to separate indirect and direct costs. The DHG audit manager also provided us with a working paper that showed DHG auditors performed an indirect cost analysis that provided some assurance regarding the adequacy of the indirect cost pool and allocation base used to compute the indirect cost rates. However, there was no documentation that the auditors verified that the indirect cost rates were properly used to charge indirect costs to Federal awards, including whether there were any negotiated rate agreements or award specific rates.

Based on the additional information provided, we concluded that the DHG auditors performed an adequate review of direct costs and a limited review of indirect costs. Therefore, we accepted that there is sufficient evidence to support the DHG audit conclusion on the allowable costs compliance requirement. However, DHG auditors should improve documentation on the audit procedures performed to review indirect costs in future audits. The procedures should include verifying that the indirect cost rates were properly charged to Federal awards.

Recommendations, Management Comments, and Our Response

Recommendation C

We recommend that the Partner, Dixon Hughes Goodman LLP:

- 1. Improve audit documentation of audit procedures in future audits on the verification of whether Logistics Management Institute properly charged indirect costs to Federal awards in compliance with Federal regulations.**
- 2. Provide the Department of Defense Office of Inspector General with the audit documentation on the FY 2016 single audit that demonstrates corrective actions taken to address the reported deficiencies for the allowable costs/cost principles compliance requirement.**

Dixon Hughes Goodman LLP Comments

The Partner, DHG, agreed to take the recommended actions and will perform audit procedures on indirect costs for the FY 2016 and future single audits to verify that the rates were properly charged to the major programs.

Our Response

Comments from the Partner addressed all specifics of the recommendation, and no further comments are required.

Appendix A

Scope and Methodology

We conducted our review from January 2016 through July 2016 in accordance with the “Quality Standards for Inspection and Evaluation,” published by the Council of the Inspectors General on Integrity and Efficiency (CIGIE) in January 2012. Those standards require that we plan and perform our review to obtain sufficient appropriate evidence to provide a reasonable basis for our findings, conclusions, and recommendations based on our objectives. We believe that the evidence obtained provides a reasonable basis for our findings, conclusions, and recommendations. We reviewed the DHG FY 2014 single audit of LMI submitted to the Federal Audit Clearinghouse on January 20, 2015. We used the 2015 edition of the CIGIE “Guide for Quality Control Reviews of OMB Circular A-133 Audits.” 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 review.

Prior Coverage

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

Appendix B

Compliance Requirements

Table. DHG 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 or Unallowed	X	
Allowable Costs/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

Dixon Hughes Goodman LLP



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August 26, 2016

DOD OIG Randolph R. Stone
Deputy Inspector General
Policy and Oversight
Office of Inspector General
Department of Defense
4800 Mark Center Drive
Alexandria, VA 22350-1500

Dear Mr. Stone:

Thank you for providing your draft report of the proposed report Project # D2016-DAPOSA-0078.000 related to our firm's audit of Logistics Management Institute's (LMI) financial statements and federal reports for the year ended September 30, 2014. Our firm places the highest priority on audit quality, and appreciates an independent review of our procedures. We have reviewed your draft recommendations based upon your quality control review that took place in our Tysons, Virginia office in January of this year. We appreciate the opportunity to provide additional information and our viewpoints regarding the draft reports.

Our comments by finding are as follows:

Finding A: Internal Control and Compliance with Procurement, Suspension and Debarment

The DOD Office of Inspector General (OIG) indicated that DHG did not provide sufficient evidence to support conclusions that internal controls were operating effectively over procurement, suspension and debarment. Additionally, the OIG indicated that DHG did not perform sufficient compliance testing over procurement, suspension and debarment.

Response:

DHG developed and documented its understanding of internal controls over compliance with procurement, suspension and debarment. The audit team identified the key control over procurement to be that LMI utilizes a file checklist to document appropriate review and applicable approvals over the basis for contractor selection, basis for award cost or price, and justification for lack of competition when competitive bids or offers are not obtained. The audit team documented the inquiry of this control with the Controller and corroborated the inquiry with the Director of Contracts. Additionally, the audit team identified the key control over suspension and debarment to be that LMI's Buyers use SAM (Systems for Award Management) to run a debar status check on all awards greater than \$10,000 (internal threshold) and that this check is included in the contract file. The audit team documented the inquiry of this control with the Controller and corroborated the inquiry with the Director of Contracts. The audit team tested the key controls and found no exceptions. However, we acknowledge that documentation could be improved to reflect that the detailed testing performed with respect to procurement, suspension and debarment included a review of these controls (vendor and file checklists).



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For compliance testing, DHG selected a sample of 100 expenditures at random to ensure appropriate coverage. The random sample selection yielded 65 payroll expenditures, to which procurement, suspension and debarment requirements would not be applicable. The sample yielded 35 non-payroll expenditures, over which DHG performed compliance testing over suspension and debarment. DHG found no exceptions during this testing.

DHG Action: As requested by the DOD OIG office, DHG will re-perform procedures over internal controls over procurement, suspension and debarment and document results to provide sufficient evidence to support our conclusion over internal controls over compliance with procurement, suspension and debarment. In addition, DHG will perform procedures over compliance with suspension and debarment for an additional five expenditures and will perform procedures over compliance with procurement requirements.

Finding: Internal Control Testing over Cash Management and Reporting

The OIG indicated that DHG did not provide sufficient evidence to support conclusions that internal controls were operating effectively over cash management and reporting.

Response:

DHG developed and documented its understanding of internal controls over compliance with cash management and reporting. The audit team identified the key control over cash management to be that LMI's Controller reviews and approves all cash drawdowns and requests for reimbursement prior to invoice submission. The audit team documented the inquiry of this control with the Controller and corroborated the inquiry with the Assistant Controller over billings. In addition, DHG tested a sample of requests for reimbursement that agreed the cash receipt to supporting documentation (reimbursement request or invoice) showing that costs for which the reimbursement was requested were paid prior to the date of the reimbursement request. However, we acknowledge that documentation could be improved to reflect the testing performed with respect to the internal control over cash management which was noting that the approval by the Controller indicated his review over cash management, specifically the key control above.

DHG developed and documented its understanding of internal controls over compliance with reporting. The audit team identified the key control over reporting to be that editorial and technical quality reviews are performed over all deliverables excluding the monthly status reports to clients. The audit team documented the inquiry of this control with the Controller and corroborated the inquiry with the principal Subcontracts Administrator and the Director of Contracts, noting that performance reports and special reporting were not required under the R&D grant cluster. As a result, the audit team determined that reporting did not have a direct and material effect on the major program. (OMB A-133 Subpart E – Auditors .500(d) Compliance – "In addition to the requirements of GAGAS, the auditor shall determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs.")

DHG Action: As requested by the OIG office, DHG will re-perform procedures over internal controls over cash management and document procedures performed to provide sufficient evidence to support our conclusion over internal controls over compliance with cash management. In addition, DHG will improve documentation to support that reporting does not have a direct and material effect on the major program, and perform procedures to justify management's representation that performance reports and special reporting were not applicable to the major program.

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Finding B: Subrecipient Monitoring Compliance

The OIG indicated that DHG did not have sufficient support for their determination that the subrecipient monitoring compliance requirement was not direct and material to the research and development cluster.

Response:

The AICPA Audit and Accounting Guide "Government Auditing Standards and Single Audits" as of April 1, 2015 (recently updated on May 1, 2016), section 12.24 states that "the auditor's consideration of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of a reasonable person who will rely upon the auditor's work. A comparison of the amount of federal funds passed through to subrecipients with the total amount of expenditures for each individual major program or cluster can assist the auditor in determining if the pass-through amount is material. When the amount of federal funds passed through to subrecipients is material either quantitatively or qualitatively, in relation to the major program being audited, the auditor is required to test subrecipient monitoring for the program". Paragraph 12.25 in part additionally states, "Tests of internal control over compliance related to subrecipient monitoring may include inquiry, observation and inspection of documentation, or a reperformance by the auditor of some or all of the pass-through entity's monitoring activities. The nature and extent of the tests performed will vary depending on the auditor's assessment of inherent risk of noncompliance, understanding of the internal control over compliance, materiality, and professional judgment. The results of the auditor's testing of internal control over compliance assist in determining the nature, timing, and extent of subrecipient monitoring compliance testing."

We performed inquiry procedures over monitoring of subcontract expenses performed by management, and performed detail testing of program costs for both the R&D cluster and 2 additional major programs for 2014. It has been the opinion of LMI management that none of the subcontracts in question met the criteria for subrecipient classification. This conclusion is in line with the determination made in prior audits by this firm and the audit firm that preceded our firm. During our detail testing of expenditures, nothing came to our attention that would lead us to question LMI management's representation.

For the fiscal year ended September 30, 2014, the amount of funds passed through to subcontractors that were identified by LMI to be subrecipients, was \$50,354. The fact that these subcontractors identified LMI as a pass-through does not mean LMI's conclusion on vendor versus subrecipient determination is incorrect. In addition, this amount represents approximately 0.068% of the research and development cluster (\$50,354/\$74,086,057) and is deemed to be clearly immaterial to the R&D cluster. As such, in our judgment, we were not required to perform testing over LMI's monitoring of these subawards. However, we do believe we could have documented our view of the materiality of this matter more clearly and performed further procedures.

DHG Action: As requested by the DOD OIG office, DHG will document LMI's specific criteria for determining whether a subcontractor is or is not a subrecipient and the process for applying that criteria and LMI's review steps over that process. DHG additionally will document the amount of subcontract costs which were charged to the R&D cluster during 2014 and based upon that data, make and document a determination whether subrecipient monitoring is a direct and material compliance requirement. If subrecipient monitoring is determined to be a direct and material compliance requirement, DHG will sample and test for both compliance and the effectiveness of LMI's internal control over subrecipient monitoring compliance.

For Findings A and B, DHG will provide the IG with the corresponding audit documentation and revise the Office of Management and Budget Circular A-133 report to reflect the additional work performed.

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Finding C: Indirect Costs

The OIG indicated that DHG did not adequately perform and document audit procedures to verify that indirect costs were properly charged to Federal awards.

Response:

DHG analyzed indirect costs by obtaining an understanding of the indirect cost rates and indirect cost pools, as well as the rate and base for each pool. DHG then determined that there was no change in the rates from fiscal 2013 to fiscal 2014 and performed procedures to determine that the pools were reasonable in the aggregate.

DHG Action: As requested by the DOD OIG office, DHG will perform procedures on indirect costs for the fiscal 2016 and future audits to verify that the rates were properly charged to the major programs, not just over indirect cost pools in total.

Thank you for your consideration of our Firm's responses. We plan to address the action items during our fiscal September 2016 interim field work which is scheduled to begin the week of August 29, 2016. We are available at your convenience to discuss this communication.

Yours truly,



David L. Johnson, CPA
Partner

Acronyms and Abbreviations

- CIGIE** Council of the Inspectors General on Integrity and Efficiency
- DHG** Dixon Hughes Goodman LLP
- LMI** Logistics Management Institute
- OMB** Office of Management and Budget
- SEFA** Schedule of Expenditures of Federal Awards



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