Oversight Review March 7, 2012

Report on Quality Control Review of the Raich Ende Malter & Co. LLP FY 2009 Single Audit of the Riverside Research Institute

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March 7, 2012

Board of Trustees
Riverside Research Institute

Treasurer
Riverside Research Institute

Audit Partner
Raich Ende Malter & Co.LLP


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. As the cognizant Federal agency for the Riverside Research Institute (the Institute), we performed a review of the Raich Ende Malter & Co. LLP (the audit firm) single audit and supporting documentation for the audit period December 1, 2008, through November 30, 2009. The purpose of our review was to determine whether the single audit was conducted in accordance with auditing standards and the auditing and reporting requirements of the Office of Management and Budget Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations,” (Circular A-133). Appendix A contains additional background, scope, and methodology of the review. Appendix B lists the compliance requirements the audit firm considered applicable to the FY 2009 single audit.

Background. Riverside Research Institute, located in New York City, is a non-profit organization engaged in scientific and engineering research. Substantially all revenue is derived from contracts with United States Government agencies. The Institute expended $69 million in Federal awards for the fiscal year ended November 30, 2009, under one Federal program, the research and development cluster. Of the $69 million, $30.1 million was expended for Department of Defense programs.

Review Results. Raich Ende Malter & Co. LLP failed to perform, document and report on the FY 2009 audit of Federal programs in accordance with auditing standards and Circular A-133 audit and reporting requirements (Findings A and B). Raiche Ende and Malter audit of internal control and compliance was based on a determination that 10 of the 14 compliance requirements were applicable to the Institute. However, the audit working papers for all 14 of the compliance requirements were not adequate to support conclusions on applicability, internal control and the audit opinion on compliance with laws, regulations and award provisions applicable to the

1 Auditing standards include both Government Auditing Standards and the American Institute of Certified Public Accountants’ audit standards.
research and development cluster program. In addition, the audit firm did not appropriately report an audit finding disclosed in the audit. Because of these audit deficiencies, Federal agencies cannot rely on the audit report for assurance that the Institute managed Federal awards in compliance with laws, regulations and award provisions.

Riverside Research Institute did not have an understanding of the requirements for preparing the Schedule of Expenditures of Federal Awards (Schedule) and the Accounting Director informed us that the Schedule provided to the audit firm may not have appropriately identified and classified all Federal and pass-through awards in the research and development cluster. Because the audit firm did not perform appropriate procedures to verify the award information in the Schedule, there is no assurance that the single audit covered all Federal awards expended or administered by the Institute in FY 2009 (Finding A). Because of the extent of the audit deficiencies the FY 2009 audit needs to be re-performed at no additional cost to the government.

Management Comments and DoD IG Response. Raiche Ende Malter and the Institute agreed to take the recommended actions. Management comments were responsive and conform to requirements; no additional comments are needed. Management comments are included in their entirety at the end of this report.

Finding A. Preparation and Review of the Schedule of Expenditures of Federal Awards to Support the Federal Program Audit. The Institute did not prepare the Schedule of Expenditures of Federal Awards in accordance with Circular A-133 requirements and the audit firm did not perform procedures to verify the completeness and accuracy of the Federal award information presented. Since the Schedule serves as the primary basis for determining the scope of the Federal program audit, there is no assurance that the audit of Federal programs properly included all Federal and pass-through awards expended and administered by the Institute in FY 2009.

Circular A-133 §__.310 provides the requirements for the auditee's preparation of the Schedule. The Schedule must cover the same period as the financial statements, include total fiscal year expenditures for all Federal and pass-through awards, and include award identifying information and notes describing the significant accounting policies used in preparing the Schedule.

The Circular and the American Institute of Certified Public Accountants Audit Guide “Government Auditing Standards and Circular A-133 Audit” provide the audit requirements and suggested procedures for performing and documenting the review of the Schedule in both the financial statement and the Federal program audit. The purpose of these procedures is to determine whether the Schedule provides an appropriate basis for planning the Federal program audit.

Preparation of the Schedule of Expenditures of Federal Awards. Based on discussions with the Institute’s Director of Finance, we have no assurance that the Schedule was prepared in accordance with Circular A-133 requirements. Specifically, the Director was uncertain if the accounting records used to prepare the Schedule accurately identified awards by
agency and award type, and whether the information related to pass-through and classified awards were accurate and complete.

**Audit of the Schedule of Expenditures of Federal Awards.** The working papers did not contain any evidence to support that the audit firm performed procedures in the Federal program audit to determine if the Schedule information provided an appropriate basis for setting the scope of the single audit. Specifically, there was no evidence to support that the auditor gained an understanding of the internal controls over the preparation of the Schedule or performed procedures to determine the accuracy and completeness of Federal award information.

**Finding B. Performance, Documentation and Reporting in Accordance with Auditing Standards and Circular A-133 Requirements.** The audit firm failed to perform the review of internal control and compliance of the research and development cluster in accordance with auditing standards and Circular A-133 requirements. Specifically, the audit firm did not properly determine and document the compliance requirements subject to audit; perform and document adequate internal control review procedures; and perform and document adequate compliance testing of all applicable requirements. In addition, the audit firm failed to properly evaluate, document, and report an internal control deficiency in the single audit report. Because of these deficiencies, the audit lacked sufficient, appropriate audit evidence to support the audit conclusions on internal control and the opinion on compliance and failed to provide Federal program managers with information needed to ensure accountability over Federal program funds. As a result, Federal agencies should not rely on the audit to manage and monitor program awards at the Institute.

**Applicability of Compliance Requirements.** The auditors determined that the Davis Bacon Act, real property acquisition and relocation assistance, subrecipient monitoring, and special tests and provisions were not applicable to the FY 2009 audit. As a result, they did not perform any audit procedures to review the Institute's internal control over compliance or compliance with these requirements. However, the auditor did not adequately document the basis for excluding these requirements from the audit. Therefore, there was insufficient evidence to determine if all direct and material compliance requirements were included in the scope of the FY 2009 single audit.

Circular A-133 requires the auditor to determine whether the auditee complied with all laws, regulations and award provisions that may have a direct and material effect on the audited Federal programs. To assist the auditor, the Circular A-133 Compliance Supplement (the Supplement) provides guidance on the identification and testing of applicable compliance requirements. Specifically, Part 2 “Matrix of Compliance Requirements”, identifies the compliance requirements that are generally applicable to the research and development cluster, and Part 3 "Compliance Requirements" states that in making a determination not to test a compliance requirement the auditor must conclude that a particular compliance requirement should not be tested, either because it does not apply to the auditee or that a noncompliance would not have a direct and material effect on the audited program. Auditing standards require that the auditor prepare audit documentation in sufficient detail so that an experienced auditor,
with no previous experience with the audit, understands the work performed, the evidence obtained and the conclusions reached.

**Review and Testing of Internal Control Over Compliance.** The audit firm did not perform and document adequate procedures for the review of internal control over compliance for the following compliance requirements identified by the auditor as applicable: allowable activities; allowable cost; cash management; period of availability of Federal funds; eligibility; equipment and real property management; matching, level of effort and earmarking; procurement, suspension and debarment; program income; and reporting.

Auditing standards and Circular A-133 require the auditor to perform risk assessment procedures to obtain an understanding of internal control over compliance and to evaluate the design and implementation of internal controls over compliance for each applicable compliance requirement. The purpose of the procedures is to determine whether the controls are capable of preventing, detecting and correcting material noncompliance. As part of the review of internal control, the auditor must also identify and test the operating effectiveness of key internal controls they intend to rely on in order to assess the risk of noncompliance due to the control environment. This assessment is used to establish the nature, timing and extent of compliance testing needed to obtain sufficient and appropriate evidence to support the audit conclusions on compliance. The auditor is required to document the risk assessment procedures performed, the results obtained and the conclusions reached.

**Allowable activities, allowable cost, cash management and period of availability of Federal funds.** The audit firm did not perform adequate risk assessment procedures for these compliance requirements. Although the audit program required the auditor to document, in a memorandum, their understanding and testing of internal control, the only documentation in the audit files was a listing of control characteristics with checkmarks alongside all the listed characteristics. There was no documentation to support that the auditor interviewed Institute personnel, inspected internal control manuals, or observed activities to gain an understanding of the control process. The documentation did not provide evidence that the auditor identified and evaluated the design and implementation of any internal controls or identified key controls for testing. Although the documentation indicated that the auditor performed limited testing of approvals for the allowable activities and allowable cost requirements, there is no audit trail back to the risk assessment procedures to support that the auditor intended to identify approvals as a key control. There was no documentation to support any testing of key internal controls for the period of availability of Federal funds and cash management requirements.

**Eligibility, equipment and real property management; matching, level of effort and earmarking; procurement, suspension and debarment; program income, and reporting.** There was no documentation to support that the auditor performed any procedures to gain an understanding of internal control over compliance or performed any further required procedures for the review of internal control over compliance for these compliance requirements. As a result of the inadequate review of internal control over compliance, the auditor had no basis for establishing the nature, timing and extent of compliance testing needed to obtain sufficient evidence to support the audit conclusions on compliance.
Review and Testing of Compliance with Program Requirements. The audit firm did not perform and document adequate procedures to support the conclusions on compliance for the following compliance requirements identified by the auditor as applicable: allowable activities; allowable cost; cash management; period of availability of Federal funds; eligibility; equipment and real property management; matching, level of effort and earmarking; procurement, suspension and debarment; program income; and reporting.

Auditing standards and Circular A-133 require auditors to use the results of the review of internal control as a basis for planning and performing audit procedures to determine compliance for all direct and material compliance requirements. In order to assist the auditor in obtaining sufficient and appropriate evidence to support the audit conclusions on compliance, the standards, the American Institute of Certified Public Accountants Audit Guide, and the Supplement provide requirements and guidance on audit sampling. The Supplement also identifies the audit objectives and provides suggested audit procedures for each compliance requirement.

Guidance on sampling is contained in the auditing standards and the American Institute of Certified Public Accountants Audit Guide “Government Auditing Standards and Circular A-133 Audits”. The guidance provides sampling considerations and documentation requirements to ensure that the sampling approach used in the single audit provides sufficient and appropriate evidence. The guidance covers ensuring that the sample population is appropriate for the audit objective, that the sample size is consistent with the determined risk of noncompliance, and that the sample selection process results in a sample that is representative of the universe. In addition, the Supplement Part 5, “Clusters of Programs” provides specific sampling guidance for the research and development cluster, and states that the sample selected should come from a variety of award sizes, types and funding sources. This guidance is intended to address the unique factor that the cluster is normally composed of awards from many Federal agencies and is intended to ensure that the sample is drawn from the entire universe of awards in order to provide appropriate coverage for all Federal agencies.

Sampling. The sampling approach did not ensure that the auditor sampled across the universe of research and development awards. Rather, the auditor selected transactions from five contracts to test compliance with allowable activities, allowable cost, cash management and period of availability of Federal funds requirements. As a result, the sample was not representative of the universe because all Federal agency awards did not have an equal chance of being included in the transaction test sample. In addition, because the auditor did not perform an adequate review of internal control over compliance there was no basis to support that the sample size provided sufficient evidence to support the audit conclusions on these compliance requirements. Furthermore, forty percent of the transactions tested were from fixed-price contracts. Fixed-Price contracts are not subject to Circular A-133 audit requirements. Therefore, a significant portion of the sample transactions did not provide appropriate evidence to support the conclusions on compliance.
Allowable cost, cash management, period of availability of Federal funds, earmarking, and program income. In addition to the flawed sampling approach, the auditors did not perform and document adequate procedures to test compliance with these requirements.

Allowable costs. The auditors did not identify the specific cost principle criteria that the transactions were tested against. As a result, there is no evidence to support the audit conclusions that the Institute was in compliance with the allowable cost principles.

Cash management. Under the Institute's reimbursement method, the objective for compliance with cash management requirements is to ensure that program costs are paid with Institute funds before reimbursement is requested from the Federal government. However, the planned procedures did not identify, consider, or verify any information to or from reimbursement requests submitted to the government.

Period of availability of Federal funds. The audit objective for the period of availability is to verify whether Federal funds were obligated within the prescribed period of availability and that obligations were liquidated within the required time period. However, there is no evidence that the audit procedures accomplished this objective because the working papers did not identify beginning and ending dates of the awards or otherwise identify the period of availability for the awards tested.

Earmarking and program income. Earmarking requirements are unique to each Federal program award and the audit objective is to verify that required minimum or maximum amounts or percentages are used for the specified activities. Program income is gross income received during the award period that is directly generated by federally funded projects in activities such as rental fees or sales of items made under the award agreement. The audit objective for research and development awards is to verify that the program income was added to the project budget. In order to accomplish the audit objective for earmarking and program income, the auditor must first identify awards that contain these requirements.

The review of these two requirements was inadequate because the auditors did not have an understanding of the compliance requirements and did not specifically identify whether any awards had earmarking or program income requirements. Because of the specific nature of these requirements, the auditor should have designed the sample to include a population of awards appropriate for testing to the audit objectives. However, none of the awards tested included any earmarking requirements and the working papers did not document any awards with program income requirements. Rather, the auditors considered normal expense reimbursements received from the government as program income and verified that the payments received by the Institute matched the invoices submitted to the government. We discussed the lack of appropriate audit procedures with the audit firm and were advised that the auditors misunderstood the audit objectives for both these compliance requirements.
Eligibility; equipment and real property management; matching and level of effort; procurement, suspension and debarment; and reporting. There was no documentation to support that the audit firm performed any compliance testing for these compliance requirements.

Evaluation and Reporting of a Deficiency in Internal Control. The auditors did not comply with auditing standards and Circular A-133 requirements because the working papers did not document that the auditor performed procedures to evaluate the potential impact of an internal control deficiency on Federal program compliance. In addition, the audit documentation evaluating the impact of the deficiency on financial reporting was inconsistent, and the reporting of the deficiency did not comply with auditing standards and Circular A-133 requirements. As a result, Federal program managers were not aware of internal control and potential compliance issues that would impact the degree of oversight needed to adequately monitor the Institute’s management of Federal funds.

Circular A-133 requires reporting all significant deficiencies in internal control, material noncompliance with compliance requirements, and known or likely questioned costs greater than $10,000 as audit findings in the “Schedule of Findings and Questioned Costs.” For internal control deficiencies over financial reporting that do not rise to the level of a significant deficiency, the auditor can determine whether and how to report to management. This communication may be done in the form of a management letter and if the auditor does so, the letter should be referenced in the report on internal control over financial reporting. Furthermore, a management letter cannot be used to communicate any audit findings that are required to be reported under Circular A-133.

In performing our review, we became aware that the auditor issued a management letter to the Institute’s Board of Trustees. The letter communicated a significant deficiency in internal control over the payroll process disclosed during the financial statement audit. Specifically, the auditors determined that due to a lack of adequate internal control over the payroll process, a terminated employee continued to be compensated for 3 months after termination. However, the documentation did not clearly support the auditor’s evaluation of the severity of the deficiency or the impact, if any, of the deficiency on Federal program compliance. There was an inconsistency between the working papers and the management letter on the evaluation of the severity of the deficiency. The evaluation of a deficiency is critical to ensuring that all required audit findings are properly reported. The working paper titled “Control Deficiency Evaluation and Aggregation Worksheet,” identifies the finding as a control deficiency while the management letter to the Board of Trustees reports the finding as a significant deficiency. In addition, because substantially all Institute revenues are generated from Federal awards the auditor should have at a minimum, designed, performed and documented the audit procedures to assess the impact of the deficiency on the risk of noncompliance with the allowable cost requirements and determined whether any payroll expenses were improperly charged to Federal awards.

Because there was no documentation to support an assessment of the internal control deficiency on Federal programs and no documentation to explain the inconsistency on the evaluation of the severity of the deficiency, we are unable to determine whether the auditor reported all of the audit findings as required under Circular A-133.
Summary. The Raich Ende Malter & Co audit work does not meet the requirements of the auditing standards and the Circular A-133 audit requirements. As a result, Federal agencies and pass-through entities cannot rely on the audit for assurance that the Institute managed Federal awards in compliance with laws, regulations and award provisions. Additional audit procedures must be performed, at no additional cost to the government, before the audit report can be used by Federal agencies and pass-through entities to monitor and manage awards to the Riverside Research Institute.

Under Circular A-133 the Institute is responsible for selecting the auditor to perform the single audit and is also responsible for ensuring that the audit is performed in accordance with Circular A-133 requirements. Circular A-133 §__230(b)(1) prohibits the Institute from charging the cost of any single audit that was not conducted in accordance with Circular A-133 audit requirements to a Federal award. Therefore, any costs billed by the audit firm for the FY 2009 single audit must be accumulated separately as unallowable costs and cannot be charged to Federal awards until the audit is corrected.

In addition, because of the extent of deficiencies disclosed by our review, we conclude that the Raich Ende Malter & Co auditors that performed the Institute single audit lacked an understanding of single audit requirements. Also, the supervision provided was not adequate to ensure compliance with auditing standards and Circular A-133 requirements.

Recommendations and Management Comments.

1. We recommend that the Treasurer, Riverside Research Institute:

   a. Prepare a revised Schedule of Expenditures of Federal Awards in accordance with Circular A-133 requirements and provide the Schedule to Raich Ende Malter & Co to redo the FY 2009 single audit to address the deficiencies identified in this report at no additional cost to the government.

   b. Identify as unallowable, any costs associated with audit services billed by Raich Ende Malter & Co for the original FY 2009 single audit until the audit is performed in accordance with Circular A-133 requirements.

   c. Submit the revised FY 2009 Circular A-133 reporting package and Data Collection Form with the Federal Audit Clearinghouse and promptly notify the DoD Office of Inspector General when the submission actions are completed.

The Institute Comments. The Director of Finance, Riverside Research Institute agreed to take the recommended actions. Management comments are included in their entirety at the end of this report.
2. We recommend that the Audit Partner, Raich Ende Malter & Co:

a. Redo the FY 2009 single audit of Riverside Research Institute in accordance with Circular A-133 requirements and the audit procedures should ensure correction of the specific deficiencies identified in this report.

b. Revise the reporting package to reflect, at a minimum, the date the revised audit work was completed.

c. Provide the revised audit reporting package to the Institute for submission to the Federal Audit Clearinghouse.

d. Develop or obtain a training program for auditors performing single audits; assess the technical abilities of auditors and supervisors assigned to perform single audits; and ensure the appropriate level of supervision commensurate with the technical assessment to ensure that the audits comply with Circular A-133 requirements.

Raiche Ende and Malter Comments. The Audit Partner, Raiche Ende and Malter agreed to take the recommended actions. Management comments are included in their entirety at the end of this report.

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

Randolph R. Stone, SES
Deputy Inspector General
Policy and Oversight
Appendix A. Quality Control Review Process

Background, Scope and Methodology

The Single Audit Act, Public Law 98-502, as amended, was enacted to improve the financial management of State and local governments, and nonprofit organizations by establishing a uniform set of auditing and reporting requirements for all Federal award recipients required to obtain a single audit. Circular A-133 establishes policies that guide the implementation of the Single Audit Act, and provides an administrative foundation for uniform audit requirements of non-Federal entities administering Federal awards. Entities that expend $500,000 or more in a year are subject to the Single Audit Act and audit requirements in Circular A-133. Therefore, they must have an annual single or program-specific audit performed under government auditing standards and submit a complete reporting package to the Federal Audit Clearinghouse.

We reviewed the Raich Ende Malter & Co FY 2009 single audit of Riverside Research Institute and the reporting package that was submitted to the Federal Audit Clearinghouse on March 31, 2009, using the 1999 edition of the “Uniform Quality Control Guide for the A-133 Audits” (the Guide). The Guide applies to any single audit that is subject to the requirements of Circular A-133 and is the approved President’s Council on Integrity and Efficiency checklist for performing quality control reviews. The review was conducted in accordance with the Quality Standards for Inspection and Evaluation. We performed the review from September 2010 through September 2011. The review focused on the following qualitative aspects of the single audit:

- Qualification of Auditors,
- Independence,
- Due Professional Care,
- Planning and Supervision,
- Audit Follow-up,
- Internal Control and Compliance testing,
- Schedule of Expenditures of Federal Awards, and
- Data Collection Form.

2 The President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency combined into the Council of the Inspectors General on Integrity and Efficiency in accordance with the Inspector General Reform Act of 2008.
### Appendix B. Compliance Requirements

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<th>OMB Circular A-133 Compliance Requirements</th>
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<th>Not Applicable</th>
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<td>Allowable Costs/Cost Principles</td>
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<td>Cash Management</td>
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<td>Program Income</td>
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3 Applicability of compliance requirements as determined by Raich Ende Malter & Co. As noted in the appendix, the auditors determined that certain compliance requirements were not applicable to the FY 2009 audit. However, as discussed in Finding B to this report the working papers did not provide sufficient evidence to support excluding these requirements from the scope of the audit.
Riverside Research Institute Comments

January 25, 2012

Inspector General
Department of Defense
Attn: Felicia Fuller
400 Army Navy Drive
Arlington, VA 22202-4704


Dear Ms. Fuller:

We are in receipt of Riverside Research Institute’s portion of the draft report referenced above dated September 30, 2011. As the party ultimately responsible for the information reported via the Schedule of Expenditures of Federal Award, we are initiating responses on the recommendations provided to Riverside Research in the report.

Riverside has researched the OMB reporting requirements and has determined the original 2009 SEFA was completed incorrectly.

Response to Recommendations

1. a. A revised Schedule of Expenditures of Federal Awards will be produced in accordance with Circular A-133 requirements.

1. b. Riverside will classify as unallowable those costs associated with audit services billed by Raich Ende Malter & Co for the original 2009 single audit until the audit is performed in accordance with A-133 requirements. Riverside does not expect to receive any billings from Raich Ende on any remaining work to be done to successfully complete the 2009 single audit report.

1. c. The revised 2009 SEFA will be provided to Raich Ende. Once Raich Ende completes the re-work and provides us with their updated report, it will be submitted along with the Data Collection Form to the Federal Audit Clearinghouse. Riverside will notify the DoD Office of the Inspector General when the submissions are completed.

Regards,

Michael F. Cade
Director of Finance
Riverside Research Institute
February 9, 2012

Mr. Randolph R. Stone, SES
Deputy Inspector General
Policy and Oversight
Department of Defense
400 Army Navy Drive
Arlington, VA 22202-4704


Dear Mr. Stone:

In response to the recommendations directed to Raich Ende Malter & Co. LLP (the “audit firm”) in the above referenced draft report, we submit our plan of action, as follows:

- **Recommendation 2(a)** - Based upon the findings contained in the above referenced draft report and the restated SEFA, we will revise and perform additional audit procedures as deemed necessary to support our audit opinion. In certain instances, we will enhance the level of our prior audit documentation to support the related audit conclusions.

- **Recommendation 2(b)** - A revised reporting package for November 30, 2009 will be prepared and submitted by Riverside Research Institute (“Riverside”) to reflect the revised Schedule of Expenditures of Federal Awards in accordance with Circular A-133 requirements. The revised reporting package will incorporate additional procedures performed to address the deficiencies identified in the report. The revised reporting package will include the date the revised audit work was completed.

- **Recommendation 2(c)** - After receiving the revised 2009 SEFA from Riverside, we will perform the necessary re-work and provide Riverside with an updated report.

- **Recommendation 2(d)** - The audit firm is developing a program for additional continuing professional education (CPE) specific to Governmental Auditing Standards and Circular A-133 audits. Professional staff working on these types of engagements will be required to attend. Training will be provided by both external CPE providers and qualified firm professional staff. Internal inspections will be performed by the audit firm’s quality control department on a routine basis to assess the technical abilities of the engagement team performing single audits.

We appreciate the recommendations made during your review process and would be pleased to meet with you to discuss anything further.

Sincerely,

[Signature]

Andrew Levine, Partner

cc: Felicia M. Fuller, M.S.A.

Alld