



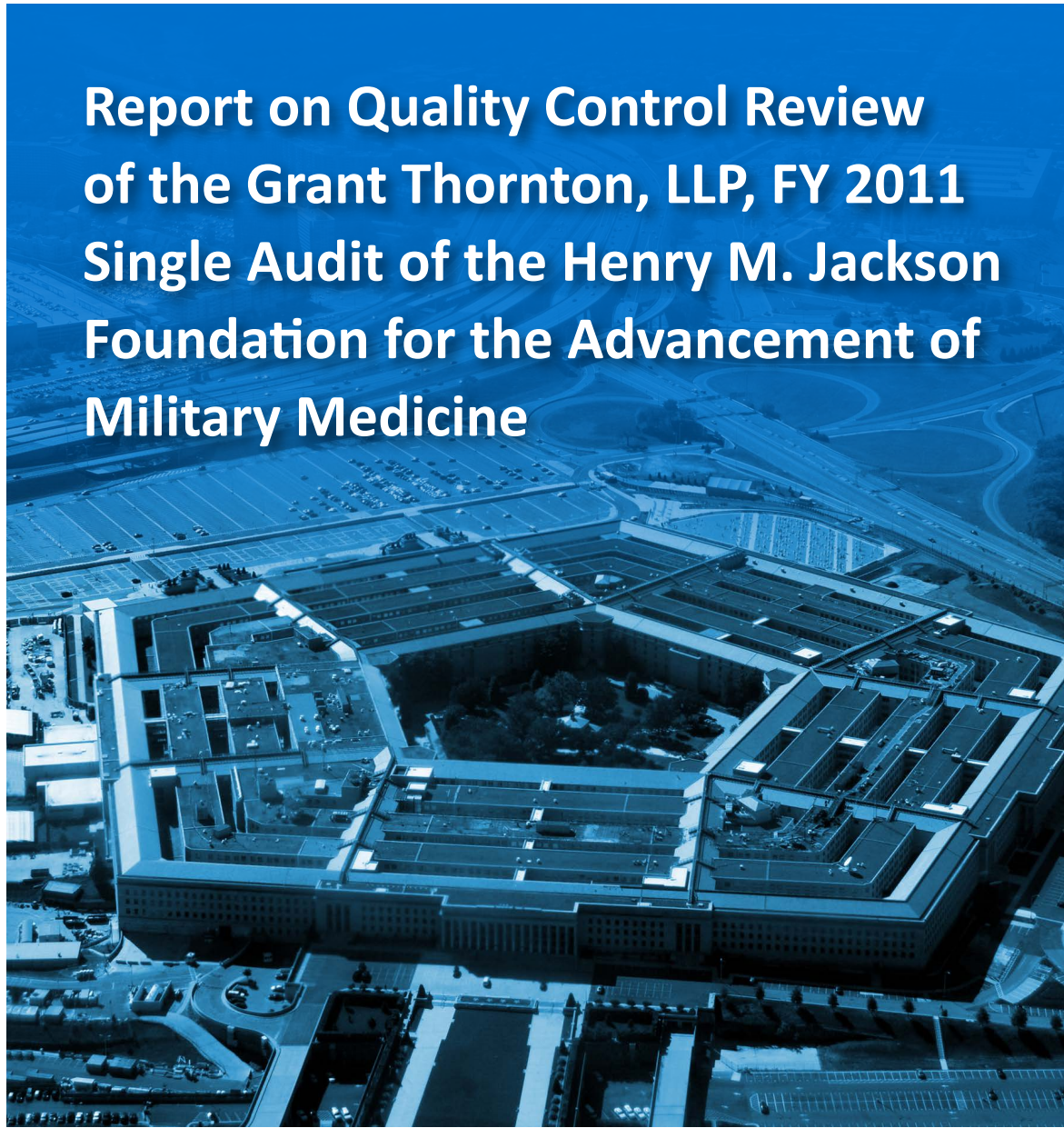
# INSPECTOR GENERAL

*Department of Defense*

AUGUST 26, 2013



## Report on Quality Control Review of the Grant Thornton, LLP, FY 2011 Single Audit of the Henry M. Jackson Foundation for the Advancement of Military Medicine



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ALEXANDRIA, VIRGINIA 22350-1500**

August 26, 2013

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Professional Standards Group  
Grant Thornton, LLP

Audit Partner  
Grant Thornton, LLP

**SUBJECT: Quality Control Review of the Grant Thornton, LLP, FY 2011 Single Audit of the Henry M. Jackson Foundation for the Advancement of Military Medicine (Report No. DODIG-2013-124)**

We are providing this report for your information and use. As the cognizant Federal agency for the Henry M. Jackson Foundation for the Advancement of Military Medicine, we began a review of the Grant Thornton, LLP single audit and supporting work papers for the year ended September 30, 2011. The purpose of our review was to determine whether the single audit was conducted in accordance with government auditing standards, the American Institute of Certified Public Accountants' auditing standards, and the auditing and reporting requirements of Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

We discontinued our quality control review after we learned a staff auditor had falsified workpapers; therefore, the audit report opinion on compliance with requirements on the Federal program cannot be relied on. Grant Thornton, LLP needs to perform additional audit procedures to support the audit conclusions and overall audit opinion. We will reschedule our review once the additional audit work is completed and the audit report is resubmitted to the Federal Audit Clearinghouse.

We considered management comments on the draft of this report. The management comments were responsive; therefore, additional comments are not required.

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).

A handwritten signature in purple 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

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## Objective

As the cognizant Federal agency for the Henry M. Jackson Foundation for the Advancement of Military Medicine (the Foundation), we began a review of the Grant Thornton LLP (Grant Thornton), single audit and supporting working papers for the audit period October 1, 2010 through September 30, 2011. The purpose of our review was to determine whether the single audit was conducted in accordance with auditing standards<sup>1</sup> and the auditing and reporting requirements of the Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," (Circular A-133). Appendix A contains additional criteria, scope, and methodology of the review; and Appendix B lists the compliance requirements that Grant Thornton determined to be applicable to the FY 2011 audit.

## Background

The Foundation is a not-for-profit organization authorized by Congress in May 1983 to support military medical research. The Foundation administers, manages, and supports scientific programs that benefit members of the armed forces and civilians. During FY 2011, the Foundation expended \$398.4 million in Federal awards, under one Federal program, the research and development cluster. Of the \$398.4 million, \$335.9 million was expended for Department of Defense programs.

## Review Results

We discontinued our quality control review due to the determination that some of the Grant Thornton work papers could not be relied on and, therefore, neither could the audit report opinion on compliance with requirements on the Federal program. Grant Thornton needs to perform additional audit procedures to support the audit conclusions and overall audit opinion (Finding A). We will reschedule our review once the additional audit work is completed and the audit report is resubmitted to the Federal Audit Clearinghouse.

Although we are discontinuing our review, we identified an issue with Grant Thornton's sampling policy that needs to be addressed to ensure the audit procedures performed for all single audits are sufficient to support the opinion on compliance with requirements on Federal programs (Finding B).

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<sup>1</sup> Auditing standards include both government auditing standards and the American Institute of Certified Public Accountants' audit standards.

## **Management Comments and DoDIG Response**

The National Managing Partner, Professional Standards Group, Grant Thornton, LLP, 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

### Performance of Federal Program Audit

Grant Thornton reviewed a sample of transaction items to evaluate the Foundation's compliance with applicable compliance requirements. We performed re-testing of several transaction items included in the sample to determine whether the audit procedures performed were sufficient to support audit conclusions. The re-testing consisted of examining the source documents reviewed by the Grant Thornton auditors. As a result of our analysis, we detected several irregularities and requested additional information and clarification from Grant Thornton auditors. In response to our inquiries, Grant Thornton performed further research and determined that some items in the sample were not part of the Foundation's transactions for FY 2011. Grant Thornton informed us that one staff auditor falsified work papers by copying transactions from the prior year single audit and changing the dates of the transactions to make them appear to be FY 2011 transactions. These false transactions were included in the sample used for several compliance requirements. Due to the seriousness of the situation, Grant Thornton stated that they were investigating the matter, had terminated the auditor who falsified work papers, and were performing additional audit work to support its audit opinion on the Foundation's FY 2011 single audit.

### Recommendations, Management Comments, and Our Response

#### ***Recommendation A***

We recommend that the National Managing Partner, Professional Standards Group, Grant Thornton, LLP, provide the DoD Office of Inspector General with:

1. The results of the Grant Thornton investigation into the matter of the falsified work papers,
2. A list of all Circular A-133 audits and any audits impacting DoD on which the Grant Thornton auditor who falsified work papers was assigned,
3. The role of the auditor and any specific actions taken on the audit(s) identified above, and



### *Grant Thornton Comments*

The National Managing Partner, Professional Standards Group, Grant Thornton, LLP, agreed to provide the requested information for Recommendations A.1, A.2, and A.3 by September 15, 2013.

### *Our Response*

Grant Thornton comments were responsive to the recommendations. No additional comments are needed.

4. Any corrective actions taken, including changes to Grant Thornton's supervisory review process and overall quality control procedures.

### *Grant Thornton Comments*

The National Managing Partner, Professional Standards Group, Grant Thornton, LLP, stated that Grant Thornton has a zero-tolerance policy for the conduct that occurred and that they would reinforce the importance of exhibiting ethical behavior at the next local office audit training and as part of their annual national core training. She also stated they will consider whether there are changes they could make to their system of quality control and would provide this information by September 15, 2013.

### *Our Response*

Grant Thornton comments were responsive to the recommendation. No additional comments are needed.

## Finding B

### Audit Sample Size Determination

The auditors did not adequately plan the audit because they did not assess the significance of the internal control being tested when determining the size of the audit sample. Guidance on sampling is contained in “Government Auditing Standards and Circular A-133 Audits” (the Audit Guide)<sup>2</sup> issued by the American Institute of Certified Public Accountants (AICPA). The guidance provides sampling considerations, including an assessment of the significance of the internal control, to ensure that the sampling approach used in the single audit provides sufficient and appropriate evidence. Grant Thornton auditors did not document in the work papers an assessment of the significance of the control being tested because they disagree with the Audit Guide and believe its policy yields a sample size sufficient to test any particular control. Due to the lack of adequate documentation, we were unable to conclude that the sample size tested provided sufficient evidence to support the conclusions on the operating effectiveness of internal controls.

### Sampling Considerations

Circular A-133 requires auditors to plan the testing of internal control over major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program. Chapter 11 of the Audit Guide provides considerations in designing an audit approach that includes audit sampling to achieve both compliance and internal control over compliance related audit objectives in a Circular A-133 audit. Specifically, the Audit Guide provides suggested minimum sample sizes designed to provide sufficient appropriate audit evidence that controls are operating effectively; however, the guide states that auditors may need to use professional judgment to determine if larger sample sizes are warranted. The minimum sample sizes identified in the Audit Guide (see Table) require the auditor to assess both the inherent risk factors and the significance of the control being tested when no deviations<sup>3</sup> are expected.

<sup>2</sup> The AICPA Audit Guide is an interpretative publication issued under the authority of the Auditing Standards Board. The members of the Accounting Standards Board have found the auditing guidance to be consistent with existing Statements on Auditing Standards.

<sup>3</sup> A deviation is a departure from the expected performance of the prescribed control.

*Table. AICPA Audit Guide – Control Testing Sample Size*

Significance of Control and Inherent Risk of Compliance Requirement	Minimum Sample Size (0 deviations expected)
Very significant and higher inherent risk	60
Very significant and limited inherent risk or Moderately significant and higher inherent risk	40
Moderately significant and limited inherent risk	25

Grant Thornton auditors documented their assessment of the inherent risk factors for each of the compliance requirements but did not assess the significance of the control being tested because they followed their own internal policy to determine the size of the sample selected for testing internal controls and compliance. The Grant Thornton sampling policy states that a sample size of 25 items should be used when performing tests of controls when no deviations are expected.

## Significance of Control

The Audit Guide states that the auditor should use the information gathered by performing the risk assessment procedures to determine the nature, timing, and extent of further audit procedures to be performed for each control selected for testing, as well as to assist the auditor in determining the significance of the control. All controls that the auditor determines must be tested to mitigate the risk of material noncompliance are significant controls, but a spectrum exists as to the significance of each control. Several factors may be considered in determining the significance level of a control including the potential magnitude of noncompliance to the program if the particular control were to fail and the number of controls selected for testing. For instance, if payroll was a large portion of expenditures for the program, the internal control tested would likely be considered very significant. However, if the auditor planned to test complementary, compensating, or redundant controls over payroll, each control would more likely be assessed as moderately significant.

In a sampling policy memorandum dated August 18, 2011, Grant Thornton states that “the opinion expressed does not depend on the effectiveness of any one control, rather efficient sample sizes are achieved because many controls are tested in an integrated audit, and other tests are performed in a financial statement or compliance audit.” Yet, for the Foundation’s single audit, Grant Thornton limited the testing to one key control for many of the compliance requirements. When only one control is selected for testing, we generally would conclude that control is very significant, especially without documentation in the work papers to indicate otherwise. Therefore, Grant Thornton may not have met

the minimum sample sizes, identified in the Audit Guide, necessary to support the audit conclusions that the Foundation's internal controls were operating effectively.

## Grant Thornton's Sampling Policy

The Grant Thornton policy memorandum does not agree with the Audit Guide regarding an assessment of the significance of the control being tested. Grant Thornton stated the Audit Guide inappropriately focused on the controls as if the objective of the audit was to express an opinion on the effectiveness of each control selected for testing. Specifically, Grant Thornton stated that they do "not apply a separate risk assessment process to each control selected for testing" because they "believe that this could lead the auditor to incorrectly responding to the risk of noncompliance by performing more control testing when the risk is higher rather than testing compliance." In effect, Grant Thornton believes the Audit Guide could lead the auditor to perform more testing on controls in response to the assessed risks instead of increasing the testing of compliance with requirements. The Grant Thornton policy states that its established sampling methodology is a risk-based approach that focuses on key controls and yields a sample size of 25, which Grant Thornton considers sufficient to test for any particular control. In our opinion, Grant Thornton incorrectly interprets the Audit Guide as focusing on internal controls rather than providing guidance on factors that should be addressed to ensure the sample size selected in a Circular A-133 audit will provide sufficient appropriate audit evidence that controls are operating effectively. The determination of whether controls are operating effectively impacts the auditors' determination of the compliance testing sample size necessary to support the overall audit opinion on compliance with requirements on the Federal program.

Although Grant Thornton disagrees with several points made in the guide, disagreement is not a sufficient basis for not following the guidance. AICPA interpretative publications, including the Audit Guide, provide recommendations on the application of Statements on Auditing Standards (SAS) in specific circumstances. If an auditor does not apply the auditing guidance included in an applicable interpretive publication, the auditor is required to explain how they complied with the SAS provisions addressed by the auditing guidance. In its policy memorandum, Grant Thornton stated that the Audit Guide presented one of many different methodologies that could be developed to address the number of occurrences of a control to test. However, the AICPA added Chapter 11 to the Audit Guide specifically to address the wide disparity in the number of items tested for compliance and for internal control over compliance, as reported in the President's Council on Integrity and Efficiency "Report on National Single Audit Sampling Project,"

June 21, 2007. Chapter 11 was developed by a task force comprised of a wide range of auditors having expertise in performing single audits, as well as in audit sampling, to provide consistency in determining the number of transactions tested, and in documenting tests performed and populations from which they are drawn. Therefore, we do not believe the intent of the Audit Guide was to provide one example of many different methodologies that could be used but was designed to ensure sufficient appropriate evidence is obtained to support the auditors' conclusions on internal control and compliance.

## **Recommendations, Management Comments, and Our Response**

### ***Recommendation B.1***

We recommend that the National Managing Partner, Professional Standards Group, Grant Thornton, LLP revise the Grant Thornton sampling policy to include steps on how to determine and document the significance of the internal controls being tested according to the auditing guidance in the AICPA Audit Guide.

#### ***Grant Thornton Comments***

The National Managing Partner, Professional Standards Group, Grant Thornton, LLP, stated that Grant Thornton revised its sampling policy on June 25, 2013 to include audit steps to determine and document the significance of the internal controls that are identified for testing for all Circular A-133 audits. The revisions were made to align their audit approach with the most recent AICPA Audit Guide and were effective immediately.

#### ***Our Response***

Grant Thornton comments were responsive to the recommendations. No additional comments are needed.

### ***Recommendation B.2***

We recommend that the Audit Partner, Grant Thornton, LLP assess the significance of the internal controls being tested, according to the auditing guidance in the AICPA Audit Guide, when determining the sample sizes for the FY 2011 Single Audit on the Henry M. Jackson Foundation for the Advancement of Military Medicine.

#### ***Grant Thornton Comments***

The National Managing Partner, Professional Standards Group, Grant Thornton, LLP, stated that the Audit Partner and engagement team were assessing the significance

of internal controls to determine the sample sizes for the FY 2011 single audit on the Henry M. Jackson Foundation for the Advancement of Military Medicine. This assessment and any related testing of additional items, is expected to be completed by September 15, 2013.

*Our Response*

Grant Thornton comments were responsive to the recommendations. No additional comments are needed.



## Appendix A

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### Quality Control Review Process

#### ***Criteria, 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 in accordance with government auditing standards and submit a complete reporting package to the Federal Audit Clearinghouse.

We performed a limited review of the Grant Thornton, LLP, FY 2011 single audit of the Foundation and the reporting package that was submitted to the Federal Audit Clearinghouse on June 28, 2012, using the 2010 edition of the “Guide for Quality Control Reviews of OMB Circular Audits” (the Guide). The Guide applies to any single audit that is subject to the requirements of Circular A-133 and is the approved Council of Inspectors General on Integrity & Efficiency checklist for performing quality control reviews.

We performed our review from January 2013 through June 2013. However, we were unable to complete the review due to the determination that some of the Grant Thornton work papers, and therefore, the single audit opinion, could not be relied on. We will reschedule our quality control review once the additional audit work is completed and the audit report is resubmitted to the Federal Audit Clearinghouse.

#### ***Prior Quality Control Review***

Since October 1, 2008, we performed one quality control review of Grant Thornton, LLP Circular A-133 audits. The quality control review identified deficiencies resulting in findings and recommendations on the Schedule of Expenditures of Federal Awards and audit documentation. Unrestricted IG DoD reports can be accessed at <http://www.dodig.mil/pubs/index.cfm?office=Audit Policy and Oversight>.

***DoD IG Report***

Report No. 2012-DoDIG-029, "Report on Quality Control Review of Grant Thornton, LLP  
FY 2009 Single Audit of Concurrent Technologies Corporation," December 5, 2011

# Appendix B

## Compliance Requirements

OMB Circular A-133 Compliance Requirements	Applicable	Not Applicable/ Not Material
Activities Allowed/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	

Note: This chart reflects Grant Thornton’s determination of the compliance requirements that are applicable and material to the major program.

## Appendix C

### Grant Thornton, LLP Comments



Grant Thornton

July 31, 2013

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

Grant Thornton LLP  
175 W Jackson Boulevard, 20th Floor  
Chicago, IL 60604-2687  
T 312.856.0200  
F 312.595.4719  
www.GrantThornton.com

Dear Mr Stone,

Grant Thornton LLP (or the Firm) is providing responses to the findings and recommendations in the letter the firm received dated July 9, 2013 with the subject "Report on Quality Control Review of the Grant Thornton, LLP, FY 2011 Single Audit of the Henry M. Jackson Foundation for the Advancement of Military Medicine (Project No. D2013-DAPOSA-0079.000)". We have formatted this letter to include your findings/recommendations followed by our response.

#### **Finding A – Performance of Federal Program Audit**

Grant Thornton reviewed a sample of transaction items to evaluate the Foundation's compliance with applicable compliance requirements. We performed re-testing of several transaction items included in the sample to determine whether the audit procedures performed were sufficient to support audit conclusions. The re-testing consisted of examining the source documents reviewed by the Grant Thornton auditors. As a result of our analysis, we detected several irregularities and requested additional information and clarification from Grant Thornton auditors. In response to our inquiries, Grant Thornton performed further research and determined that some items in the sample were not part of the Foundation's transactions for FY 2011. Grant Thornton informed us that one auditor falsified work papers by copying transactions from the prior year single audit and changing the dates of the transactions to make them appear to be FY 2011 transactions. These false transactions were included in the sample used for several compliance requirements. Due to the seriousness of the situation, Grant Thornton stated that they were investigating the matter, had terminated the auditor who falsified work paper, and were performing additional audit work to support its audit opinion on the Foundation's FY 2011 single audit.

Grant Thornton LLP  
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## Grant Thornton, LLP Comments (cont'd)



2

**Recommendation A.** We recommend that the National Managing Partner, Professional Standards Group, Grant Thornton LLP, provide the DoD Office of Inspector General with:

**Recommendation A.1:** The results of the Grant Thornton investigation into the matter of the falsified work papers.

Grant Thornton Response: We will provide a summary of the results of the investigation into this matter. The summary will be provided by September 15, 2013.

**Recommendation A.2.** A list of all Circular A-133 audits and any audits impacting DoD on which the Grant Thornton auditor who falsified work papers was assigned.

**Recommendation A.3.** The role of the auditor and any specific actions taken on the audit(s) identified above.

Grant Thornton Response to Recommendation A.2. and A.3. We agree to provide the name of the audit clients and the role of the staff auditor on those engagements but request that this information not be made publicly available in order to protect the confidentiality of Grant Thornton's clients. This information will be provided by September 15, 2013 on a confidential basis.

**Recommendation A.4.** Any corrective actions taken, including changes to Grant Thornton's supervisory review process and overall quality control procedures, to ensure this type of situation does not recur.

Grant Thornton Response: Grant Thornton consistently emphasizes to all personnel that they should follow the firm's guiding principles in everything they do. At the beginning of national meetings and training sessions, the guiding principles are discussed. Further, the firm has a Code of Conduct which each professional must acknowledge. As a firm, we demonstrate a zero-tolerance policy for this type of conduct and the individual was terminated immediately. We will reinforce the importance of exhibiting ethical behaviour in everything we do as part of the next local office audit training and as part of our annual national core training. We will also consider whether there are changes that could be made in our system of quality control that would address this situation. We will provide a summary of these corrective actions taken by September 15, 2013.

### Finding B - Audit Sample Size Determination

The auditors did not adequately plan the audit because they did not assess the significance of the internal control being tested when determining the size of the audit sample. Guidance on sampling is contained in "Government Auditing Standards and Circular A-133 Audits" (the Audit Guide) issued by the American Institute of Certified Public Accountants (AICPA). The guidance provides sampling considerations, including an assessment of the significance of the internal control, to ensure that the sampling approach used in the single audit provides sufficient and appropriate evidence. Grant Thornton auditors did not document in the work papers an assessment of the significance of the control being tested because they disagree with

Grant Thornton LLP  
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## Grant Thornton, LLP Comments (cont'd)



3

the Audit Guide and believe its policy yields a sample size sufficient to test any particular control. Due to the lack of adequate documentation, we were unable to conclude that the sample size tested provided sufficient evidence to support the conclusions on the operating effectiveness of internal controls.

**Recommendation B.1.** We recommend that the National Managing Partner, Professional Standards Group, Grant Thornton, LLP revise the Grant Thornton sampling policy to include steps on how to determine and document the significance of the internal controls being tested according to the auditing guidance in the AICPA Audit Guide.

Grant Thornton Response: On June 25, 2013 the Firm revised its sampling policy to include steps for audit teams to determine and document the significance of the internal controls that are identified for testing for all Circular A-133 audits. The revisions were done to align the Firm's audit approach with the most recent AICPA Audit Guide, "Government Auditing Standards and Circular A-133 Audits." This policy was effective immediately, including in-process engagements.

**Recommendation B.2.** We recommend that the Audit Partner, Grant Thornton, LLP assess the significance of the internal controls being tested, according to the auditing guidance in the AICPA Audit Guide, when determining the sample sizes for the FY 2011 Single Audit on the Henry M. Jackson Foundation for the Advancement of Military Medicine.

Grant Thornton Response: The Audit Partner and engagement team are in the process of assessing the significance of the internal controls that were selected for testing pursuant to the recommendations included in the report, consistent with the Firm's revised policies, to determine the sample sizes for the FY 2011 Single Audit on the Henry M. Jackson Foundation for the Advancement of Military Medicine. This assessment, and any related testing of additional items, is expected to be completed by September 15, 2013.

Sincerely,

A handwritten signature in black ink that reads "Karin A. French".

Karin A. French  
National Managing Partner of Professional Standards



## Acronyms and Abbreviations

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**AICPA** American Institute of Certified Public Accountants

**OMB** Office of Management and Budget

**SAS** Statements on Auditing Standards

# **Whistleblower Protection**

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